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No. 87-

Supreme Court, U.S.
FILED
APR 22 1988
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE SOUTHLAND CORPORATION, RAY BERRY, TAL COLSON, KEITH JENKINS, ROBERT DUNCAN, JOHN P. THOMPSON, JERE W. THOMPSON, WALTON GRAYSON III, JOSEPH S. HARDIN, R G SMITH, EUGENE PENDER, S.R. DOLE, and TERRY DE BARD,

Petitioners,

v.

RICHARD D. and DARLA J. KEATING, MICHAEL M. and GLORIA G. COY, and HARRY BATTERSBY on behalf of themselves and all other persons similarly situated,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPERIOR COURT OF THE COUNTY OF ALAMEDA, CALIFORNIA

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QUESTION PRESENTED

Whether the Federal Arbitration Act and the Supremacy Clause of the United States Constitution bar a state court from superimposing the state's statutes and procedures relating to class actions on a private arbitration of a commercial dispute involving interstate commerce.

PARTIES BELOW

This Petition involves three cases that were coordinated for pretrial purposes in the court below.* Plaintiff-respondents are the following former franchisees of 7-Eleven® convenience stores in California: Richard and Darla Keating, Harry Battersby, and Michael and Gloria Coy. These plaintiffs purport to represent a class consisting of all individuals who have owned 7-Eleven franchises in California at any time between May 1973 and the present.**

Defendants are The Southland Corporation, which owns the 7-Eleven® service mark, and several of its current and former officers, directors and employees: John P. Thompson, Jere W. Thompson, Walton Grayson III, Joseph S. Hardin, R G Smith, Eugene Pender, S.R. Dole,

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* The three cases are among a group of eight actions that were coordinated in the Superior Court for the County of Alameda, California, under the caption *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387. The three cases that are the subject of this Petition are: *Coy* v. *Southland*, Alameda County No. 506120-6; *Battersby* v. *Southland*, Santa Clara No. 390132; *Keating* v. *Southland*, Napa County No. 37402.

** The other five cases included in the *Market Franchise Cases* do not purport to be class actions and are not involved in this Petition. The plaintiffs in those five cases are Edward and Betty Gouveia, Patrick and Cathy Cheng, Phillip and Joan Newell, Thomas and Wanda Sampson, and Arthur and Jenny Scovis. All of these individuals are former franchisees of 7-Eleven stores in California.

Ray Berry, Tal Colson, Keith Jenkins, Robert Duncan, and Terry De Bard.

The Southland Corporation has no parent corporations or subsidiaries, other than wholly owned subsidiaries. Southland owns a 50% interest in CITGO Petroleum Corportation.***

*** Since this Petition challenges the constitutionality of California's class action law as applied in this litigation, 28 U.S.C. § 2403(b) may be applicable. Accordingly, Southland is serving a copy of this Petition on the Attorney General of California. *See* Sup. Ct. R. 28.4(c).

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IN THE

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OCTOBER TERM, 1987

No. 87-

THE SOUTHLAND CORPORATION, *et al.*,
Petitioners,

v.

RICHARD D. KEATING, *et al.*,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE SUPERIOR COURT OF THE COUNTY OF ALAMEDA, CALIFORNIA

Petitioners, The Southland Corporation and several of its current and former officers, directors and employees (hereinafter collectively referred to as "Southland" or "petitioners"), seek a writ of certiorari to review an order entered by the Superior Court for the County of Alameda, California on June 26, 1987. The Supreme Court of California denied Southland's petition for review of that order, without opinion, on February 25, 1988.

At an earlier stage of this litigation, this Court noted probable jurisdiction to consider the issue presented here, but ultimately did not decide it. *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984). The Court remanded the litigation for further proceedings, but on remand the California courts acted contrary to this Court's mandate and did not address the issue.

OPINIONS BELOW

The June 26, 1987 order of the Superior Court of the County of Alameda, California, requiring the parties to arbitrate their disputes in a court-supervised class action arbitration, is unreported. That order, together with the Superior Court's accompanying Statement of Decision, is reprinted in the Appendix to this Petition at 1a-15a (hereinafter "App."). The orders of the California Court of Appeal and of the California Supreme Court, denying review of the class certification order, are not reported. These orders are reprinted at App. 16a, 17a and 19a.

This Court's decision in *Southland Corp.* v. *Keating*, *supra*, is reprinted at App. 75a-109a. In *Keating*, this Court reversed in part, and remanded for further proceedings, a decision of the California Supreme Court, *Keating* v. *Superior Court*, 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982). That decision is reprinted in the Appendix at 24a-74a.

JURISDICTION

The order that is the subject of this Petition was entered by the California Superior Court on June 26, 1987. Petitioners timely sought review of the order in the California Court of Appeal, but on December 16, 1987, that court dismissed the appeal and declined to review the order in a discretionary writ proceeding. (App. 16a-17a.) Petitioners then asked the California Supreme Court to review the class certification order, but, by order dated February 25, 1988, that Court declined to exercise its discretionary jurisdiction. (App. 19a.)

This Court has jurisdiction under 28 U.S.C. § 1257(3) (1982) because petitioners contended in the courts below that (i) a statute of the United States (*i.e.*, the Federal Arbitration Act) confers a right, privilege or immunity that protects them from the class action arbitration procedure mandated by the California courts, and (ii) Cali-

fornia's class action statute as applied to petitioners is invalid and preempted by the Federal Arbitration Act.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The constitutional provisions and statutes involved in this Petition are as follows:

The Supremacy Clause, U.S. Const. art. VI, cl. 2

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2 (1982)

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 382 of the California Code of Civil Procedure (West 1973)

> If the consent of any one who should have been joined as plaintiff cannot be obtained, he may be made a defendant, the reason thereof being stated in the complaint; and when the question is one of a common or general interest, of many persons, or when the parties are numerous, and it is impracti-

cable to bring them all before the court, one or more may sue or defend for the benefit of all.

STATEMENT OF THE CASE

This litigation has a ten-year history, which includes a prior decision by this Court. *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984). Yet the underlying merits of the parties' dispute still have not been reached. Southland has been fighting for a decade to enforce its arbitration agreement with the respondents, and plaintiff-respondents have been attempting to avoid arbitration altogether, or, in the alternative, to encumber it with extensive, judicially supervised procedures.

This Court held in *Keating* that the respondents could not avoid their arbitration agreement by relying on state laws and policies that favored a judicial forum. However, on remand they nonetheless managed to return the case to the judicial forum by persuading the California Superior Court to require the arbitration to proceed as a court-supervised class action. In so holding, the court refused to consider Southland's argument that this state-imposed procedure would violate the Supremacy Clause of the United States Constitution by impairing the exercise of rights protected by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.* (1982). The California court implicitly ruled that the California Supreme Court had already rejected Southland's preemption argument, even though this Court had held in *Keating* that "the state courts did not decide whether . . . state law imposing class-action procedures was preempted by federal law." 465 U.S. at 8.

In brief, the history of Southland's attempt to obtain the benefits of arbitration has been as follows:

In May 1977, Richard and Darla Keating sued Southland in the Superior Court for Santa Clara County, California. Plaintiffs were franchisees of a 7-Eleven convenience store. They alleged that their franchisor, Southland, had used an accounting system for their store that

was unfair and/or inaccurate and that Southland had made certain fraudulent representations to them concerning the accounting system. They asserted claims for common law fraud, breach of contract, breach of fiduciary duty and violation of the California Franchise Investment Law.[1] Plaintiffs purported to represent a class of all individuals who have owned 7-Eleven franchises in California at any time since May 1973. Thereafter, the other respondents filed similar complaints, and the actions were coordinated for pretrial proceedings in the Superior Court for Alameda County.

The franchise agreements provided that "[a]ny controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . ." *See* 465 U.S. at 4. Nevertheless, plaintiffs resisted arbitration and, as a fallback position, suggested that if their claims were arbitrable, the court should create a procedure whereby the arbitration would be conducted as a court-supervised class action.

The California Superior Court, by orders entered in February and July 1978, generally upheld the arbitration agreement, except with regard to the statutory claim under the Franchise Investment Law. The court did not decide whether the arbitration should proceed as a class action.

In August 1980, the California Court of Appeal reversed the ruling that the arbitration agreement was unenforceable with respect to claims under the Franchise Investment Law. *Keating* v. *Superior Court*, 109 Cal. App. 3d 784, 167 Cal. Rptr. 481 (1980). The court also held, however, that there is no "insurmountable obstacle"

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[1] The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees, and prohibits franchisors from making fraudulent or misleading statements to prospective franchisees. *See* Cal. Corp. Code § 31000 *et seq.* (West 1977).

to conducting an arbitration on a class-wide basis, and it remanded the litigation to the trial court for class certification proceedings. 167 Cal. Rptr. at 492.

Southland then petitioned the California Supreme Court to review the class action ruling. Plaintiffs cross-petitioned for review of the Court of Appeal's decision on the arbitrability of the statutory claims. The California Supreme Court, by a divided vote of 4-2, affirmed the Court of Appeal's ruling on the availability of a class action arbitration procedure and reversed the ruling that claims asserted under the California Franchise Investment Law are arbitrable. *Keating* v. *Superior Court*, 31 Cal.3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982). The court remanded for a determination whether a class action would be appropriate in these particular cases.

On appeal to this Court, Southland argued that the Federal Arbitration Act preempted the California Franchise Investment Law to the extent that it permitted parties to interstate contracts containing arbitration clauses to sue in court. This Court agreed. *Keating*, *supra*, 465 U.S. at 10-16. The Court also noted probable jurisdiction over the issue whether the Federal Arbitration Act barred the states from superimposing class action policies and procedures on arbitration agreements. However, plaintiffs contended before this Court that the class action issue had been decided "solely in terms of state law" in the California courts and that the Court therefore lacked jurisdiction to decide the federal preemption question.[2] This Court agreed and found that it therefore did not have jurisdiction to consider the issue. *Id.* at 9. It remanded the class action arbitration issue to the California courts for further proceedings. *Id.* at 17.

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[2] Brief for Appellees at 13, *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984) (Docket No. 82-500). *See also* Respondents' Motion to Dismiss at 6, *id.*

Following remand in 1984, the plaintiffs amended their complaints and undertook extensive discovery, purportedly addressed to the class action question. The parties thereafter filed extensive briefs and evidentiary submissions. Southland specifically argued, among other things, that a class action arbitration would be preempted by federal law.[3] In response, plaintiffs contradicted what they had represented to this Court, arguing that the California Supreme Court had implicitly rejected Southland's preemption argument in its 1982 opinion.[4]

After oral argument, the Superior Court ruled in a one-page minute order that all of plaintiffs' claims were appropriate for class treatment in arbitration.[5] The order did not address preemption. Plaintiffs then submitted a proposed Order, Statement of Decision and Notice to the class. On June 19, 1987, the Superior Court issued another minute order, adopting without changes plaintiffs' submissions.[6] The court signed these papers on June 26, 1987. In accordance with plaintiffs' position, the Statement of Decision recited that the "law of the case" and "invited error" doctrines barred Southland from

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[3] *See* Memorandum of Defendant The Southland Corporation In Opposition to Plaintiffs' Motion for Class Certification at 32-45, *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387 (Superior Court of California, County of Alameda, class certified June 26, 1987).

[4] *See* Plaintiffs' Reply to Defendant's Opposition to Motion for Class Certification at 4, *id.*

[5] Order of Court re Motion for Class Certification, *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387 (California Superior Court, County of Alameda, November 10, 1986).

[6] Order of Court, *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387 (California Superior Court, County of Alameda, June 19, 1987).

raising the preemption issue. In essence, plaintiffs had convinced this Court not to review the issue in 1984 because the question *had not been* decided by the California Supreme Court, and thereafter convinced the Superior Court not to review the issue because it *had been* previously decided by the state supreme court.

Southland attempted to appeal to the California Court of Appeal and, in the alternative, to obtain a writ of mandamus or prohibition. Southland's appellate papers specifically contended that the Superior Court's class certification order was inconsistent with and preempted by the Federal Arbitration Act. However, on December 16, 1987, the Court of Appeal dismissed the appeal and denied the writ petition without opinion. (App. 16a-17a.)

Finally, Southland filed a petition for review in the California Supreme Court. Again, Southland urged reversal of the class certification on the basis of the federal constitutional issue. Review by the California Supreme Court is wholly discretionary, and, on February 25, 1988, the court declined to exercise its jurisdiction. (App. 19a.)

On March 24, 1988, Southland filed a motion in the Superior Court to stay the class action until Southland had filed, and this Court had considered, a petition for a writ of certiorari. On March 29, the case was remitted from the Court of Appeal to the Superior Court, vesting jurisdiction once again in the Superior Court. On the same day, the court stayed its class action order until April 20, 1988 in order to give Southland an opportunity to petition this Court for a stay. On April 15, Southland applied to Justice O'Connor for a stay pending consideration of this Petition and, if the Petition is granted, pending the Court's decision on the merits.

REASONS FOR GRANTING THE WRIT

The issue presented in this Petition warrants full review by this Court. The issue might have been resolved in *Keating* in 1984 but for respondents' successful contention that the California courts had not yet considered it. On remand, respondents avoided the merits again by contradicting the position they had taken in this Court. The Court should not allow its procedures to be manipulated in this fashion and should resolve the federal preemption issue once and for all.

A. The Court Has Jurisdiction

In the recent proceedings in the Superior Court on Southland's motion for a stay, respondents did not dispute that the preemption issue poses a substantial federal question, but they advanced several reasons why this Court allegedly is divested of jurisdiction. Those arguments are addressed at the outset.

1. *The Superior Court's order is a final judgment or decree rendered by the highest court of a state in which a decision could be had.*

This Court's jurisdiction requires the existence of a "[f]inal judgment[] or decree[] rendered by the highest court of a State in which a decision could be had . . . ." 28 U.S.C. § 1257 (1982). Respondents apparently contend that the Court lacks jurisdiction because the order at issue was entered by a trial court rather than the California Supreme Court and because the litigation is not at an end.

The fact that the California appellate courts have declined to review the trial court's order does not deprive this Court of jurisdiction. An order is rendered by "the highest court of the State in which a decision could be had" if the petitioner has attempted to obtain review in the highest court available. *Minneapolis St. P. & S. Ste.*

M. Ry. v. *Rock*, 279 U.S. 410, 411-12 (1929); *see also Virginian Ry.* v. *Mullens*, 271 U.S. 220, 222 (1926). If petitioner has done so, neither the state supreme court's disclamation of its discretionary jurisdiction, nor the possibility of review of the order at a later stage of the litigation, deprives this Court of jurisdiction. *See, e.g., Perry* v. *Thomas*, 107 S. Ct. 2520, 96 L. Ed. 2d 426 (1987) (review of decision of California Court of Appeal, where California Supreme Court had denied discretionary review, even though the California Supreme Court could review arbitrability issue at later stage of litigation); *Belknap, Inc.* v. *Hale*, 463 U.S. 491, 497-98 n.5 (1983); *Organization for a Better Austin* v. *Keefe*, 402 U.S. 415 (1971).

Nor is finality lacking because the overall litigation is at an "interlocutory" stage. This Court employs an "intensely 'practical' approach" to the finality requirements of 28 U.S.C. §§ 1257 and 1291. *Mathews* v. *Eldridge*, 424 U.S. 319, 331 n.11 (1976) (citations omitted). Determinations of finality must balance " 'the inconvenience and costs of piecemeal review on the one hand and the danger of denying justice by delay on the other.' " *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 171 (1974) (citation omitted). Under this test, the Court has frequently reviewed decisions that deny or burden arbitration, *Southland Corp.* v. *Keating*, *supra*; *Perry* v. *Thomas*, *supra*; *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, 460 U.S. 1 (1983), as well as decisions that raise important questions concerning class action procedures. *E.g., Eisen* v. *Carlisle & Jacquelin*, *supra*.

As this Court recognized in *Keating*, the "core purpose of a contract to arbitrate" would be defeated if the state court litigation had to run its course before important federal issues concerning arbitrability could be resolved. 465 U.S. at 7-8. To force Southland to endure a lengthy, complex, judicially supervised class action before the preemption issue is decided would deprive the com-

pany of the very rights the Federal Arbitration Act protects. Because the class action ruling threatens to erode federal policy, and because reversal of the state court on the federal issue would end the state court's proceedings, this Court has jurisdiction. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469, 482-83 (1975).

2. *The federal question was properly raised in the California courts.*

As noted, when this case was previously before this Court, respondents argued, and the Court agreed, that this Court could not consider the question whether California's class action procedures were preempted by federal law because the California appellate courts had not decided the question.[7] This Court remanded to the California courts for further proceedings on the issue. 465 U.S. at 17.

Following remand, respondents did a 180-degree turn. They argued that although the California Supreme Court had not "expressly" decided the preemption issue in the prior appeal, it had "implicitly" decided it because the issue was "essential to the [California Supreme Court's] decision."[8] The Superior Court apparently agreed, for it did not address the question whether a class action arbitration is consistent with the Federal Arbitration Act. It executed an order, in the form submitted by respondents, reciting that consideration of the preemption question is barred by the "law of the case" and "invited

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[7] Plaintiffs represented that the preemption question "was neither raised nor decided below" and that "the state courts decided the issue solely in terms of state law." Respondents' Motion to Dismiss at 6, *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984) (No. 82-500); Brief of Appellees at 13, *id.*

[8] Reply to Defendant's Opposition to Motion for Class Certification at 4, *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387 (California Superior Court, County of Alameda, class certified June 26, 1987).

error" doctrines. We anticipate that respondents will now attempt to complete their ruse by arguing that this Court lacks jurisdiction because the class action issue was decided in the court below on state-law grounds, without reaching the federal issue.[9]

Under California law, the "law of the case" doctrine applies to questions presented and decided at an earlier stage of the proceedings. *See, e.g., In re Estate of Horman*, 5 Cal. 3d 62, 73, 95 Cal. Rptr. 433, 441, 485 P.2d 785 (1971), *cert. denied*, 404 U.S. 1015 (1972). It does not apply to issues that might have been, but were not, decided. *Id.; see also Di Genova* v. *State Board of Educ.*, 57 Cal. 2d 167, 18 Cal. Rptr. 369, 367 P.2d 865, 871 (1962). Similarly, the "invited error" doctrine does not bar parties from raising new legal issues or from changing their legal arguments to remedy an error of law made at an earlier stage of the proceedings. *See Ward* v. *Taggart*, 51 Cal. 2d 736, 336 P.2d 534, 537-38 (1959); *Flores* v. *Natividad Medical Center*, 192 Cal. App. 3d 1106, 238 Cal. Rptr. 24, 30-31 (1987); *County of Madera* v. *Superior Court*, 39 Cal. App. 3d 665, 674 n.7, 114 Cal. Rptr. 283, 289 n.7 (1974). California law generally permits parties to raise any new defense following reversal and remand to the trial court. 9B Witkin, *California Procedure*, Appeal § 627, at 608 (3d ed. 1985).[10]

In the instant case, plaintiffs represented to this Court that the California appellate courts had not decided the federal preemption issue. If so, the California "law of

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[9] Respondents so argued in the court below. Plaintiffs' Memorandum in Opposition to Defendants' Motion for a Stay at 2-4, *Market Franchise Cases*, Judicial Council Coordination Proceeding No. 387 (California Superior Court, County of Alameda, class certified June 26, 1987).

[10] *See, e.g., Western Air Lines, Inc.* v. *Schutzbank*, 258 Cal. App. 2d 218, 66 Cal. Rptr. 293, 297, 300 (1968); *Steelduct Co.* v. *Henger-Seltzer Co.*, 26 Cal. 2d 634, 160 P.2d 804, 809 (1945); *Ellis* v. *Witmer*, 148 Cal. 528, 83 P. 800 (1906).

the case" doctrine does not apply, and this Court has jurisdiction under 28 U.S.C. § 1257. On the other hand, if plaintiffs' current position is the correct one—*i.e.*, if the California Supreme Court *did* decide the preemption issue in the earlier appeal—then this Court again has jurisdiction under Section 1257, which embraces any federal issue that was decided at any stage of the state court proceedings, even if it has become "law of the case." *See, e.g., Hathorn* v. *Lovorn*, 457 U.S. 255, 261-62 (1982); *Reece* v. *Georgia*, 350 U.S. 85, 87 (1955). Therefore, if plaintiffs are now suggesting that the California appellate courts implicitly rejected Southland's preemption argument in the earlier appeals, this Court has jurisdiction, notwithstanding California's "law of the case" doctrine. *See, e.g., Yazoo & Mississippi Valley Ry.* v. *Adams*, 180 U.S. 1, 9, 13-15 (1901). Respondents cannot have it both ways.

Furthermore, state-law doctrines such as "law of the case" and "invited error" cannot be invoked as a bar to review by this Court unless their application in the case at bar is consistent with the "strict[] and regular[]" practice of the state courts. *See, e.g., Hathorn* v. *Lovorn*, *supra*, 457 U.S. at 262-65.[11] In adopting plaintiffs' arguments, the Superior Court applied the doctrines in a manner that goes well beyond the normal bounds of those doctrines, for it applied them to pure questions of law and to issues that were not previously addressed.[12]

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[11] In California, the law of the case doctrine is applied as a discretionary rule rather than a jurisdictional requirement. *Judson* v. *Herrington*, 71 Cal. App. 2d 565, 566, 162 P.2d 931, 932 (1945); *see Vangel* v. *Vangel*, 45 Cal. 2d 804, 810, 291 P.2d 25, 28 (1955). In such situations, a state procedural rule does not defeat this Court's jurisdiction. *See Sullivan* v. *Little Hunting Park, Inc.*, 396 U.S. 229, 232-34 (1969).

[12] In addition to being inapplicable for the reasons discussed above, the California law of the case doctrine is inapplicable where, as here, intervening cases have changed or significantly clarified the governing law. *Subsequent Injuries Fund* v. *Industrial Accident Comm'n*, 53 Cal. 2d 392, 395, 1 Cal. Rptr. 833, 835, 348 P.2d 193

There is one issue that clearly *has* become law of the case: namely, this Court's ruling that the federal preemption issue was not considered in the earlier appeals. That being so, the California Superior Court was not free on remand to apply judicial doctrines that come into play only when an issue has been previously considered,[13] and this Court's jurisdiction cannot be defeated by the invocation of such doctrines.

B. The Question Merits Review by This Court

In recent years, this Court has held that the Federal Arbitration Act embodies a strong federal policy favoring enforcement of agreements to arbitrate disputes outside the judicial system. *See Perry* v. *Thomas*, *supra*; *Shearson/American Express, Inc.* v. *McMahon*, 107 S. Ct. 2332, 96 L. Ed.2d 185 (1987); *Mitsubishi Motors Corp.* v. *Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614 (1985); *Dean Witter Reynolds, Inc.* v. *Byrd*, 470 U.S. 213 (1985); *Southland Corp.* v. *Keating*, *supra*; *Moses H. Cone Memorial Hosp.* v. *Mercury Constr. Corp.*, *supra*. The Court has ruled that Congress intended to establish a substantive right applicable to all contracts involving interstate commerce. *Southland Corp.* v. *Keating*, *supra*, 465 U.S. at 10-16. It has held that the Act preempts any state statutes or doctrines that override arbitration agreements. *Moses H. Cone Memorial Hosp.*, *supra*, 460 U.S. at 24. Two of these cases—*Southland Corp.* v. *Keating* and *Perry* v. *Thomas*—involved situations in which California courts had upheld state laws in the face of federal preemption arguments.

(1960); *Standard Oil Co.* v. *Johnson*, 56 Cal. App. 2d 411, 132 P.2d 910 (1942).

[13] *See Vendo Co.* v. *Lektro-Vend Corp.*, 434 U.S. 425, 427-28 (1978); *In Re Sanford Fork & Tool Co.*, 160 U.S. 247, 255 (1895). Moreover, having argued to this Court that the California courts had not addressed the federal question, the plaintiffs were not free to change their position on the facts on remand. *See NAACP* v. *Alabama ex rel Patterson*, 360 U.S. 240, 243-44 (1958).

The decision of the court below nominally upholds the parties' agreement to arbitrate, but it undermines this Court's recent decisions as effectively as if arbitration had been denied altogether. The procedure mandated by the Superior Court's order, and by the 1982 decision of the California Supreme Court at an earlier stage of this litigation, is a *judicial* procedure. The class certification decision must be made by a court. *Keating, supra*, 31 Cal. 3d at 613, 183 Cal. Rptr. at 377, 645 P.2d at 1209. Discovery, briefing and hearings are generally required before the class issue can be decided,[14] and these proceedings are often complex and time-consuming. In the instant case, judicial discovery procedures were used extensively, and three-and-one-half years elapsed between this Court's decision in January 1984 and the Superior Court's class certification in June 1987. Southland's rights under the Federal Arbitration Act already have been substantially impaired.

And judicial involvement is far from over. The procedure established by the California courts contemplates that the judiciary will determine the form of notice to the class; supervise the notice and opt-out procedure; and review any proposed dismissal or settlement. *Keating, supra*, 31 Cal. 3d at 613, 183 Cal. Rptr. at 377, 645 P.2d at 1209.[15] Moreover, with respect to the arbitration itself, the California Supreme Court recognized that the Superior Court would be required to exercise "a measure of external supervision in order to safeguard the rights of absent class members to adequate representa-

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[14] Class determinations involve considerations enmeshed in the factual and legal issues comprising plaintiffs' causes of action. *General Telephone Co.* v. *Falcon*, 457 U.S. 147, 160 (1982); *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 469 n.12 (1978).

[15] In the case at bar, the Superior Court's order provides that the notice will be sent on the court's stationery, that class members will have 60 days to opt out or else be included in the class, and that, after the initial notice, the court will consider whether further notices are required. (App. 2a-3a.)

tion . . . ." *Id.* This oversight would be pervasive, because, as this Court has held, considerations of due process require active judicial involvement in all aspects of class actions.[16]

Further, class arbitration threatens to involve the judiciary in the actual merits of the parties' dispute. The Superior Court has directed the arbitrators to conduct the proceedings in conformity with its Statement of Decision on the class action issue. (App. 4a.) Among other things, that decision contains several statements concerning the admissibility of evidence and the elements of plaintiffs' claims, some of which Southland contends are erroneous as a matter of law. If the arbitrators feel constrained to abide by the Superior Court's statements, their authority will be directly impaired.[17]

Southland's position is that the procedures mandated by the California courts are the antithesis of what arbitration is supposed to entail. Arbitration is intended to be quick, informal, simple, inexpensive, private and, most of all, nonjudicial. Class actions, by their nature, are time-consuming, formalized, complex, expensive, public and judicially supervised. The procedure created by the California courts would be an arbitration in name

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[16] *See Eisen* v. *Carlisle & Jacquelin, supra,* 417 U.S. at 173-74. After a court has made an initial determination that the evidence is likely to be common to the class and that the claimants will adequately represent the class, it must continually reevaluate the situation as the case proceeds. If this is not done, and if the evidence actually presented is not applicable to the class as a whole, the judgment will not be binding on absent class members. *See General Telephone Co.* v. *Falcon, supra.*

[17] A fundamental aspect of arbitration is that the arbitrators have the authority to decide what evidence to consider, as well as to decide the merits of the case, without strict adherence to judicial rules of evidence or judicial case law. *See Lentine* v. *Fundaro,* 29 N.Y.2d 382, 328 N.Y.S.2d 418, 421, 278 N.E.2d 633 (1972); Domke, *Domke on Commercial Arbitration,* § 24.02 at 364, § 25.05 at 396-97 (Rev. ed. 1984).

only. In all other respects, it would be a two-forum, judicial monstrosity that would be more complex than if the case were in court for all purposes. Southland's position, therefore, is that the procedure poses "an obstacle to the full effectiveness of a federal statute" and is therefore invalid under article VI, clause 2 of the Constitution. *See Colorado Anti-Discrimination Comm'n* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 722 (1963).

This Court has stated that an agreement to arbitrate is "a specialized kind of forum-selection clause that posits not only the situs of suit but also *the procedure* to be used . . ."; [18] that "the unmistakably clear congressional purpose [is] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts"; [19] and that the Federal Arbitration Act calls upon the courts to move the parties to an arbitrable dispute "out of court and into arbitration as quickly and easily as possible." [20] The Court has emphasized that when parties have contracted to arbitrate, the courts must strictly enforce the agreement, even if some other procedure seems to be more efficient or more fair.[21]

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[18] *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 519 (1974) (emphasis added).

[19] *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967).

[20] *Moses H. Cone Memorial Hosp., supra*, 460 U.S. at 22.

[21] *Dean Witter Reynolds, Inc.* v. *Byrd, supra*, 470 U.S. at 216-21. The California Supreme Court based its decision on its view that it might be unfair in some situations to allow an arbitration agreement to defeat California's public policy favoring class actions. *Keating* v. *Superior Court, supra*, 31 Cal. 3d at 609, 183 Cal. Rptr. at 374-75. Under this Court's decisions, this was not an appropriate consideration. In any event, the California court overlooked the fact that the objectives of class actions (reducing the cost of prosecuting individual claims; relieving burdens on the courts) are served by arbitration as well. Arbitration assists the administration of justice by consensually removing cases from the often

Decisions by the California courts imposing class action arbitration [22] are inherently in conflict with rulings by other courts that the Federal Arbitration Act requires persons who have executed arbitration agreements to be excluded from judicial class actions.[23] Furthermore, the implications of the California court's decision go beyond the question of class actions. If state courts can nominally uphold arbitration agreements while wrapping them in complex judicial procedures, the right to arbitrate will be a hollow one. The purposes of the Federal Arbitration Act can be defeated as effectively by judicial control as by doctrines that override arbitration altogether. The case at bar therefore merits review by this Court in order to resolve the important question whether states are entitled to overlay interstate arbitration contracts with judicial procedures.[24]

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tortuous route of the judicial system and by providing a quick, inexpensive remedy to facilitate the prosecution of claims—particularly small ones.

[22] Subsequent to the California Supreme Court's 1982 decision in this case, California courts have followed that decision and have imposed class action procedures in other cases. *Izzy* v. *Mesquite Country Club*, 186 Cal. App. 3d 1309, 231 Cal. Rptr. 315 (1986); *Gainey* v. *Occidental Land Research*, 186 Cal. App. 3d 1051, 231 Cal. Rptr. 249 (1986); *Lewis* v. *Prudential Bache Securities*, 179 Cal. App. 3d 935, 225 Cal. Rptr. 69 (1986).

[23] *See, e.g., Sanders* v. *Robinson Humphrey/American Express, Inc.*, 634 F. Supp. 1048, 1064-65 (N.D. Ga. 1986), *aff'd in relevant part sub nom. Kirkpatrick* v. *J.C. Bradford & Co.*, 827 F.2d 718 (11th Cir. 1987), *cert. denied*, 99 L. Ed. 2d 421 (1988); *cf. Steinberg* v. *Prudential-Bache Securities, Inc.*, No. 8173 (Del. Ch. April 30, 1986) (Available on LEXIS: States Library, Del. File).

[24] There are many contexts in which state legislatures or courts might be tempted to impose judicial procedures on arbitration (*e.g.*, discovery rules, the rules of evidence). For example, there is "a dynamic state of conflict," *Higley South, Inc.* v. *Park Shore Dev. Co.*, 494 So. 2d 227, 229 (Fla. Dist. Ct. App. 1986), concerning the question whether a court may order two separate arbitrations to

CONCLUSION

For the reasons stated, petitioners The Southland Corporation, *et al.* request that a writ of certiorari be issued to the Superior Court of the County of Alameda, California, to review that court's decision and order of June 26, 1987.

Respectfully submitted,

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Dated: April 1988

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be consolidated, thereby altering the procedures specified in the individual arbitration agreements. *Compare Cable Belt Conveyors, Inc.* v. *Alumina Partners of Jamaica*, 669 F. Supp. 577 (S.D.N.Y. 1987), *aff'd mem.*, No. 87-7215 (2d Cir., May 20, 1987), *cert. denied*, 108 S. Ct. 161, 98 L. Ed. 2d 116 (1987) and *Compania Espanola de Petroleos, S.A.* v. *Nereus Shipping, S.A.*, 572 F.2d 966 (2d Cir. 1975), *cert. denied*, 426 U.S. 936 (1976) *with Del E. Webb Constr.* v. *Richardson Hosp. Auth.*, 823 F.2d 145 (5th Cir. 1987); and *Weyerhaeuser Co.* v. *Western Seas Shipping Co.*, 743 F.2d 635 (9th Cir.), *cert. denied*, 469 U.S. 1061 (1984).

Supreme Court, U.S.
FILED
APR 22 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1746

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE SOUTHLAND CORPORATION, RAY BERRY, TAL COLSON, KEITH JENKINS, ROBERT DUNCAN, JOHN P. THOMPSON, JERE W. THOMPSON, WALTON GRAYSON III, JOSEPH S. HARDIN, R G SMITH, EUGENE PENDER, S.R. DOLE, and TERRY DE BARD,

Petitioners,

v.

RICHARD D. and DARLA J. KEATING, MICHAEL M. and GLORIA G. COY, and HARRY BATTERSBY on behalf of themselves and all other persons similarly situated,

Respondents.

APPENDIX TO PETITION FOR WRIT OF CERTIORARI TO THE SUPERIOR COURT OF THE COUNTY OF ALAMEDA, CALIFORNIA

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SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA

Judicial Council Coordination Proceeding No. 387

Coordination Proceeding
Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

[Filed June 26, 1987]

ORDER RE MOTION FOR
CLASS CERTIFICATION

The motion of Michael M. Coy and Gloria G. Coy, Harry Battersby, and Richard D. Keating and Darla J. Keating ("the class representatives"), for class certification having duly come on for hearing before this court on September 22, 1986, John F. Wells and Lise A. Pearlman of the law firm of Stark, Stewart, Wells & Robinson appearing on behalf of the franchisees, Peter Bleakley, Mark J. Spooner and Shelley Slade of the law firm of Arnold & Porter and Charles G. Miller of the law firm of Bartko, Welsh, Tarrant & Miller appearing on behalf of The Southland Corporation, et al. The court having considered the arguments of counsel and all the papers and briefs filed by the parties, and good cause appearing therefor,

IT IS HEREBY ORDERED that:

1. The class representatives' motion for class certification is granted as to the class described and all claims set forth in the amended and supplemental complaints filed herein on April 18, 1986, except for the claims with respect to misrepresentation of the average earnings of 7-Eleven franchises contained in Counts Four, Five and Six of each of the amended and supplemental complaints.

2. Southland shall have ten (10) days from the date of this order to so notify this court if it wishes to withdraw its motion to compel arbitration and proceed with a class action in this court.

3. Southland shall identify class members and their last known addresses from its records at its expense and provide a list of the same to counsel for the franchisees within thirty (30) days of this order. If Southland does not withdraw its motion to compel arbitration, as provided above, counsel for the class within 30 days of receipt of the list shall mail notice by first class mail, postage prepaid, in the attached form to all members of the class identified by Southland. The notice shall be modified to include the name(s) of the arbitrator(s) selected by the parties as required in paragraph 7 below and a brief description of the arbitrator(s)' background and qualifications. The notice shall be printed and shall be given to Southland's counsel for comments at least ten (10) days prior to the proposed mailing. The notice shall be sent on the court's stationery and in the court's envelopes. Class members shall be given a period of sixty (60) days after the mailing of notice to opt out of the class arbitration proceedings. If Southland withdraws its motion to compel arbitration, the attached form shall be modified to reflect the change of forum and with such modification, class notice shall proceed as otherwise set forth herein.

4. Within fifteen (15) days after mailing of notice to the class, counsel for the class shall file with the court the mailing list of all persons to whom the class notice was sent. The clerk of this court will make available to counsel for plaintiffs any notices that are returned undelivered by the post office. Counsel for plaintiffs will provide defendants with a list of any such returned notices at which point the court will consider the necessity and any proposals for substituted notice and/or an extension of the period of time for opting out of the class.

5. Until the expiration of the period of time for class members to opt out of the class, Southland, its agents, employees, and counsel, and the named plaintiffs and their counsel, shall not discuss this case with members of the class, or attempt to influence any current or former 7-Eleven franchisee to opt out of the class, to join the class, or to become a named plaintiff in this dispute. Southland, its agents and employees are also prohibited from taking any action at any time to punish any franchisees for joining the class.

The court's order does not affect Southland's right to communicate with franchisees in the ordinary course of business unrelated to class claims. It also does not affect the right of plaintiffs' attorney to communicate with any franchisee or the attorney for any franchisee, who has, on his or her own initiative, consulted with plaintiffs' attorney.

After the expiration of the time for opting out, the above prohibition will remain in effect against Southland, its agents, employees, and counsel during the pendency of these proceedings. No prohibition will apply to plaintiffs' counsel with respect to communications with the class after expiration of the time for opting out.

6. Within thirty (30) days of this order, provided Southland elects to remain in arbitration, the parties shall select one or more arbitrators to arbitrate the claims

certified for class arbitration. Following class notification and an opportunity to opt out of the class, classwide arbitration shall thereafter commence in accordance with the decision of the California Supreme Court and the United States Supreme Court in this case, this order, the accompanying Statement of Decision and the terms of the parties' arbitration agreement. If Southland elects to withdraw its motion to compel arbitration, the class action shall proceed in this court.

7. As previously included in the Order of Judge Kroninger filed July 31, 1978, if the action proceeds in arbitration, Southland and the other defendants shall either abstain from the use of any discovery that they have had in any of the actions, or stipulate to discovery of at least an equally extensive nature by the franchisees.

8. Arbitration of the coordinated Gouveia, Sampson, Newell, Cheng and Mount cases is stayed pending the expiration of the time for class members to opt out of the class.

9. A stenographic record shall be made of all class proceedings before the arbitrator(s) as provided for in Section 22 of the American Arbitration Association Rules.

The court reserves jurisdiction to amend, rescind or modify this order; to consider approval of any settlement proposal; to supervise notices to the class; and to consider any application for attorneys' fees and the award of costs out of any recovery that may be obtained for the class.

Dated: June 26, 1987

/s/ Raymond L. Marsh
Judge of the Superior Court

SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA

Judicial Council Coordination Proceeding No. 387

Coordination Proceeding
Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

[Filed June 26, 1987]

STATEMENT OF DECISION

This statement of decision follows the order of this court dated November 10, 1986, granting plaintiffs' motion to certify for classwide arbitration the causes of action of the amended and supplemental complaints filed by Harry Battersby, Richard and Darla Keating and Michael and Gloria G. Coy on April 18, 1986.

This case comes before this court on remand from the California Supreme Court to consider whether classwide arbitration proceedings are appropriate in accordance with the guidelines set forth in the opinion of that court in *Keating v. Superior Court* (1982) 31 Cal.3d 584. This court has determined that such proceedings are appropriate and in the interests of justice.

Southland has argued to this court that the permissibility of class arbitration is governed by the Federal Arbitration Act. The court declines to consider this argument because the doctrines of invited error and law of the case preclude Southland from raising such argu-

ment at this point in these proceedings. This court has therefore determined the propriety of class arbitration under state law.

TRADITIONAL CONSIDERATIONS APPLICABLE TO ALL CLASS ACTIONS

In deciding a motion for class certification under Code of Civil Procedure section 382, the California Supreme Court has directed the trial courts of this state to look to Civil Code section 1781 (consumer class actions) and Rule 23 of the Federal Rules of Civil Procedure, for guidance. (*Richmond v. Dart Industries* (1981) 29 Cal.3d 462 at 469, 470 n.7 [174 Cal.Rptr. 515, 629 P.2d 23]; *San Jose v. Superior Court* (1974) 12 Cal.3d 447, 453 [115 Cal.Rptr. 797, 525 P.2d 701].) Civil Code section 1781 provides:

> "(b) The court shall permit the suit to be maintained on behalf of all members of the represented class if all of the following conditions exist:
>
> (1) It is impracticable to bring all members of the class before the court.
>
> (2) The questions of law or fact common to the class are substantially similar and predominate over the questions affecting the individual members.
>
> (3) The claims or defenses of the representative plaintiffs are typical of the claims or defenses of the class.
>
> (4) The representative plaintiffs will fairly and adequately protect the interests of the class."

Pursuant to the directive of the California Supreme Court on remand, this court makes the following determinations with respect to class certification:

1. The class defined by each of the franchisees' claims is sufficiently numerous that it is impracticable to bring

all members of the class before the court in one proceeding. (*Vasquez v. Superior Court* (1971) 4 Cal.3d 800.)

2. The class representatives' claims are typical of the claims of the class members; the class representatives will fairly and adequately protect and represent the interests of the class on each of the claims; the attorneys are qualified, experienced, and generally able to conduct the proposed class proceedings; the named plaintiffs are not involved in a collusive suit nor do they have interests antagonistic to those of the remainder of the class. (*Richmond v. Dart Industries, Inc.* (1981) 29 Cal.3d 462; *LaSala v. American Savings & Loan Association* (1971) 5 Cal.3d 864, 871.)

3. On the class claims for breach of contract and breach of fiduciary duty for alleged systematic interest overcharges, the class consists of all persons who owned California franchises at any time from and after May 24, 1973.

(a) On the contract claim, common issues of interpretation of the standardized adhesion contract and whether Southland's accounting practices breached it predominate. There are no individual issues of liability. Evidence of individualized knowledge on the part of franchisees is irrelevant to prove the meaning of the contract because the standardized adhesion contract must be interpreted to mean what a reasonable franchisee would expect it to mean. Each form of the standardized franchise agreement will mean the same thing for each franchisee who signed it. (*Gray v. Zurich Insurance Co.* (1966) 55 Cal.App.2d 263, 269-71; *LaSala v. American Savings & Loan Assn.* (1971) 5 Cal.3d 864; *McGhee v. Bank of America* (1976) 60 Cal.App.3d 442, 444-50; *Keating v. Superior Court* (1982) 21 Cal.3d 584.)

(b) On the claim for breach of fiduciary duty, common issues, including whether a fiduciary relationship existed between the franchisees and Southland, and, if so,

whether Southland breached it, predominate. There are no individual issues on liability.

4. On the claims for violation of section 31300 of the Franchise Investment Law, the class consists of all persons who became California franchisees on or after May 24, 1973.

(a) On the section 31300 claim for failure to comply with the requirements for exemption from registration set forth in Corporations Code sections 31110 and 31101, common issues of interpretation of the statutes and interpretation of Southland's uniform disclosure documents predominate over any individual issues that may arise including issues in connection with affirmative defenses based upon individual franchisee's knowledge. (Corp. Code §§ 31300, 31303.) Reliance is not an element of this claim.

(b) On the section 31300 claim that Southland sold franchises in violation of section 31202, common issues as to whether Southland wilfully misrepresented or omitted material facts required t be set forth in its disclosure documents predominate over any individual issues that may arise including issues in connection with affirmative defenses based upon individual franchisee's knowledge. (Corp. Code §§ 31300, 31303.) Reliance is not an element of this claim.

5. On the claim that Southland is liable under section 31301 of the Franchise Investment Law for selling franchises in violation of section 31201, the class consists of all persons who became California franchisees on or after May 24, 1975. Common issues include whether Southland made misrepresentations or omissions in its uniform disclosure documents used in the sale of franchises, and the materiality of any misrepresentations or omissions. These common issues predominate over any individual issues that may arise including issues in connection with affirmative defenses based upon individual

franchisee's knowledge (Corp. Code §§ 31301, 31304), and rebuttal evidence offered by Southland on the issue of reliance. Reliance on the part of all of the class members may be presumed upon a finding that any misrepresentations or omissions in the disclosure documents were material. Individualized evidence of reliance by class members is not necessary. (*Affiliated Ute Citizens v. United States* (1972) 406 U.S. 154.)

6. On the fraud claim for alleged systematic interest overcharges, the class consists of all persons who became California franchisees on or after May 24, 1974. Common issues include whether Southland made material misrepresentations or suppressed material facts in its uniform disclosure documents; and, if so, whether Southland acted with the requisite scienter. These issues predominate over any individual issues that may arise including issues with respect to rebuttal evidence relating to individual franchisee's reliance. Reliance on the part of all of the class members may be presumed from a finding of the materiality of any misrepresentations or omissions. Individualized evidence of reliance by class members is not necessary. (*Vasquez v. Superior Court* (1971) 4 Cal.3d 800.)

7. On the usury claims, the class consists of all California franchisees who paid interest to Southland on or after May 24, 1975. On the claim for recovery of interest payments in excess of the legal maximum, the common issue which predominates is whether usurious interest resulted from Southland's accounting practices. On the claim based upon the compounding of interest, the common issues which predominate are whether Southland compounded interest and, if so, whether such practice was clearly disclosed in writing. The effective rate of interest for each franchisee will have to be calculated on an individual basis.

8. On the claims for breach of contract and breach of fiduciary duty for systematic inventory overcharges, the

class consists of all persons who owned California franchises at any time from May 24, 1973, through December 31, 1978.

(a) On the contract claim, common issues of the interpretation of the standardized franchise agreement and whether Southland breached it by charging more than its average cost for franchisees' initial inventory and inventory shortages predominate. There are no individual issues of liability. Evidence of individualized knowledge on the part of franchisees is irrelevant to prove the meaning of the contract because the standardized adhesion contract must be interpreted to mean what a reasonable franchisee would expect it to mean. Each form of the standardized franchise agreement will mean the same thing for each franchisee who signed it. (*Gray v. Zurich Insurance Co.* (1966) 55 Cal.App.2d 263, 269-71; *LaSala v. American Savings & Loan Assn.* (1971) 5 Cal.3d 864; *McGhee v. Bank of America* (1976) 60 Cal.App.3d 442, 444-50; *Keating v. Superior Court* (1982) 21 Cal.3d 584.)

(b) On the breach of fiduciary duty claim, common issues which predominate include whether a fiduciary relationship exists between Southland and the franchisees, and, if so, whether Southland violated such fiduciary duty. There are no individual issues on liability.

9. On the claims for alleged violation of section 31300 due to inventory overcharges, the class consists of all persons who became California franchisees between May 24, 1973, and December 31, 1978, inclusive.

(a) On the claim for failure to comply with requirements for exemption from registration, common issues which predominate include the interpretation of the statutory requirements for exemption and whether Southland's uniform disclosure documents complied with the statutory requirements. The common issues predominate over any individual issues that may arise including issues

in connection with affirmative defenses based upon individual franchisee's knowledge. Reliance is not an element of this claim.

(b) On the section 31300 claim for the alleged sale of franchises in violation of section 31202, common issues of the interpretation of the section 31100 disclosure requirements and whether Southland's uniform disclosure documents misrepresented or omitted material facts required to be set forth predominate over any individual issues that may arise from affirmative defenses based upon individual franchisee's knowledge. (Corp. Code §§ 31300, 31303.) Reliance is not an element of this claim.

10. On the claim for violation of section 31301 of the Franchise Investment Law due to inventory overcharges, the class consists of all persons who became California franchisees between May 24, 1975, and December 31, 1978, inclusive. The common issues include whether written misrepresentations or omissions were made to the class with respect to the cost of inventory, and, if so, whether such misrepresentations or omissions were material. Such common issues predominate over any individual issues that may arise including issues in connection with affirmative defenses based upon individual franchisee's knowledge. (Corp. Code §§ 31301, 31304.) Reliance may be presumed from a finding of the materiality of any misrepresentations or omissions. Individualized evidence of reliance by class members is not necessary. (*Affiliated Ute Citizens v. United States*, *supra*, 406 U.S. 154.)

11. On the franchisees' claim for fraud based upon alleged inventory overcharges, the class is composed of all persons who became California franchisees between May 24, 1974, and December 31, 1978, inclusive. Common issues include whether Southland misrepresented

or omitted material facts respecting the cost of inventory in its uniform disclosure documents, whether any misrepresentation or omission was material, whether any misrepresentation or omission was made with the requisite scienter. Such common issues predominate over any individual issues that may arise including issues with respect to rebuttal evidence on reliance. Reliance may be presumed from a finding of materiality. Individualized evidence of reliance by class members is not necessary. (*Vasquez v. Superior Court*, *supra*, 4 Cal.3d 800.)

12. It appears that damages on all of the class claims may be estimated by mathematical formulae applied to information derived from Southland's records. In the event the class prevails on the breach of fiduciary duty claims, classwide relief will also be available in the form of an accounting and constructive trust. Punitive damages also may be awarded to the class on the breach of fiduciary duty claims, the claims for violation of the Franchise Investment Law, and the common law fraud claims should the arbitrators determine that there is a basis therefor under Civil Code section 3294. The issues whether Southland acted with fraud, malice or oppression present common issues for the class.

13. It appears that a significant number of class members executed releases upon termination of their franchise relationship with Southland. Southland raises such releases as a defense to all of the class claims asserted on behalf of those persons who have executed releases. Common issues predominate on this defense. Such common issues are whether the language of the release form includes the claims made on behalf of the class; whether the releases were procured by continuing classwide misrepresentations and/or concealment; whether the releases are invalid under Civil Code section 1542; whether the releases are invalid under the anti-waiver provisions of the Franchise Investment Law; and

whether releases signed after the first of these class actions was filed on May 24, 1977, should be invalidated because they constitute opt-outs or settlements made without court supervision and without sufficient safeguards to protect the class members' rights. Plaintiffs suggest that the issue whether releases constitute improper opt-outs should be resolved by the court rather than the arbitrators, since it is the court's responsibility to supervise class notice and opt-out procedures. The court has decided to have this issue ascertained by the arbitrators, however, in order to minimize judicial intrusion upon issues affecting the merits of the dispute.

SPECIAL CONSIDERATIONS APPLICABLE TO CLASSWIDE ARBITRATION

In addition to the traditional considerations involved in deciding whether to certify a class, the California Supreme Court has directed this court to consider the special characteristics of arbitration including the impact upon an arbitration of whatever court supervision might be required, and the availability of consolidation as an alternative means of assuring fairness. (*Keating v. Superior Court* (1982) 31 Cal.3d 584, 613.) In accordance therewith this court makes the following additional determinations:

14. Classwide arbitration in this case will be manageable. The court notes that the franchise contract calls for arbitration in accordance with the rules of the American Arbitration Association. Section 22 of those rules provides for a stenographic record of arbitration proceedings. The maintenance of such a record is appropriate in this case. It would not unduly complicate the proceedings, and would allow the court to safeguard the rights of absent class members to adequate representation. Should any questions regarding the adequacy of representation arise during the course of the arbitration,

the parties may bring the transcript before this court for its review.

15. No judicial intrusion upon the conduct of the proceedings themselves seems necessary. It will be the province of the arbitrators to determine the merits of the dispute and to refer to this court only matters which relate to class certification. The court will have continuing jurisdiction to amend, modify or rescind this order, to supervise notices to the class, determine approval of any settlement, and, in the event of any recovery for the class, to rule on any request for an award of attorneys' fees and costs out of the recovery. The impact of this role upon the arbitration proceeding itself appears minimal.

16. The court has considered consolidation as an alternative to class arbitration, and has determined that class certification would provide a better, more efficient and fairer solution to the controversy. The alterative to a class arbitration—requiring hundreds of individual franchisees each to litigate with Southland in a separate arbitration—would be entirely impractical. Due to the relatively small size of the claims being made, individual arbitration of such claims appears economically unfeasible for most class members. Refusal to certify a class would result in gross unfairness because it would effectively deny opportunity for relief to the vast majority of class members, a class proceeding being their only practical recourse.

17. Class arbitration will not prejudice the legitimate interests of Southland. If it committed classwide wrongs, it should be held accountable. If it did not, it will be exonerated in one proceeding binding all class members. Moreover, if Southland considers that the arbitral forum somehow handicaps it from presenting a proper defense, it has the option of returning the entire action to court. (*Keating v. Superior Court* (1982) 31 Cal.3d 584, 614.) This is adequate protection for its legitimate interests.

18. Southland is a large corporation of vastly superior bargaining strength to that of class members, a portion of whom are current franchisees. There is a danger that potential class members may choose to opt out of the class because of fear of adverse consequences in their ongoing relationship with Southland. The court, therefore, will order that Southland is prohibited from discussing this case or any of the class claims with any class member, from attempting to influence any class member to opt out of the class, or from taking any action to punish a class member for choosing not to opt out. Southland will not be prohibited from communicating with class members in the ordinary course of business unrelated to the class claims. (Cf. *Kleiner v. First National Bank of Atlanta* (11th Cir. 1985) 751 F.2d 1193.)

Based on the papers on file and the arguments of counsel, and for the foregoing reasons, the court has determined that class certification is in the interests of justice and has directed the franchisees' counsel to prepare a proposed form of notice to the class for this court's approval. The cost of providing the names and last known addresses of class members to counsel for the class shall be borne by Southland; the cost of mailing notice shall be borne by the class. (*Civil Service Employees Ins. Co. v. Superior Court* (1978) 22 Cal.3d 362, 378, n.9; 4 Witkin, Cal. Procedure (3d Ed. 1985) Pleading § 228, p. 227.)

Dated: June 26, 1987

/s/ Raymond L. Marsh
Judge of the Superior Court

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FOR THE FIRST APPELLATE DISTRICT
DIVISION THREE

A039472

RICHARD D. KEATING, *et al.*,
Plaintiffs and Respondents,

vs.

THE SOUTHLAND CORPORATION, *et al.*,
Defendants and Appellants.

Judicial Council Coordination Proceeding No. 387

BY THE COURT:

Respondents' motion to dismiss appeal is granted. (White, P.J., Barry-Deal, J. and Merrill, J. participated in the decision).

Dated Dec. 16, 1987

/s/ White
P.J.

IN THE COURT OF APPEAL
OF THE STATE OF CALIFORNIA
FOR THE FIRST APPELLATE DISTRICT
DIVISION THREE

A039337

THE SOUTHLAND CORPORATION, *et al.*,
Petitioner,

vs.

THE SUPERIOR COURT FOR THE COUNTY OF ALAMEDA,
Respondent;

RICHARD D. KEATING, *et al.*,
Real Party in Interest.

Judicial Council Coordination Proceeding No. 387

BY THE COURT:

Petition for writ of mandate and/or prohibition is denied. (White, P.J., Barry-Deal, J. and Merrill, J. participated in the decision).

Dated Dec. 16, 1987

/s/ White
P.J.

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA
IN BANK

No. 1/3 A039337, S003635

THE SOUTHLAND CORPORATION *et al.*,
Petitioners,

v.

SUPERIOR COURT OF THE COUNTY OF ALAMEDA,
Respondent;

KEATING *et al.*,
Real Parties in Interest.

[Filed Dec. 30, 1987]

Pending final determination of the petition for review filed herein, all proceedings in the Superior Court, County of Alameda, in Judicial Council Coordination Proceeding No. 387, entitled Richard D. Keating et al. v. The Southland Corporation et al., are hereby stayed.

/s/
Chief Justice

IN THE SUPREME COURT
OF THE STATE OF CALIFORNIA
IN BANK

1st District, Division 3, No. A039337, S003635

THE SOUTHLAND CORP *et al.*,
Petitioners,

v.

SUPERIOR COURT OF THE COUNTY OF ALAMEDA,
Respondent;

KEATING *et al.*,
Real Parties in Interest.

[Filed Feb. 25, 1988]

ORDER DENYING REVIEW
AFTER JUDGMENT BY THE COURT OF APPEAL

Petitioners' petition for review DENIED.

/s/
Chief Justice

SUPERIOR COURT OF THE STATE OF CALIFORNIA
IN AND FOR THE COUNTY OF ALAMEDA

DEPT. 20

Date: March 29, 1988 Sara Dalleske, Deputy Clerk

HON. RAYMOND MARSH, Judge Lolita Moore, Reporter

Coordination Proceeding Special Title (Rule 1550(b))

Judicial Council Coordination Proceeding No. 387

MARKET FRANCHISE CASES

Coordinated Actions:

Napa Superior Court No. 37402
(now Ala. 505159-9)

KEATING v. SOUTHLAND CORPORATION

Santa Clara Superior Court No. 361-187
(now Ala. 505161-4)

SAMPSON v. SOUTHLAND CORPORATION

Santa Clara Superior Court No. 366-559
(now Ala. 505164-1)

NEWELL v. SOUTHLAND CORPORATION

Santa Clara Superior Court No. 364-650
(now Ala. 505162-3)

CHENG v. SOUTHLAND CORPORATION

Alameda Superior Court No. 469216-2
GOUVEIA v. SOUTHLAND CORPORATION

Alameda Superior Court No. 473-115-3
SOUTHLAND CORPORATION v. GOUVEIA

Alameda Superior Court No. 506120-6
COY v. THE SOUTHLAND CORPORATION

Los Angeles Superior Court No. 0235779
THE SOUTHLAND CORPORATION v. SCOVIS

Santa Clara Superior Court No. 390-13
BATTERSBY v. THE SOUTHLAND CORPORATION

DEFENDANT SOUTHLAND'S MOTION FOR STAY PENDING U.S. SUPREME COURT REVIEW

Appearing for plaintiff's Lise Pearlman, Esq., and David Schuricht, Esq.

Appearing for defendant Southland Charles G. Miller, Esq.

The above entitled action comes regularly on calendar for hearing. The Court entertains argument. The matter is submitted. The Court orders motion for stay granted for thirty (30) days from March 21, 1988.

Parties on the attached mailing list are so notified on March 30, 1988.

by /s/ Sara Dalleske
Deputy Clerk

MAILING LIST

Judicial Council Coordination Proceeding No. 387:

MARKET FRANCHISE CASES

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SUPERIOR COURT OF CALIFORNIA
COUNTY OF ALAMEDA

Judicial Council Coordination Proceeding No. 387

Coordination Proceeding
Special Title (Rule 1550(b))

MARKET FRANCHISE CASES

[Filed Mar. 29, 1988]

ORDER GRANTING DEFENDANTS' MOTION FOR A STAY PENDING U.S. SUPREME COURT REVIEW

Upon motion of The Southland Corporation and several of its officers, directors and employees, defendants in the above-entitled cause (hereinafter collectively referred to as "Southland") for a stay of enforcement of the June 26, 1987 Order of this Court ("the Order") to enable Southland to apply for and obtain a writ of certiorari from the Supreme Court of the United States, and good cause therefor being shown,

IT IS ORDERED that the enforcement of the June 26, 1987 Order be, and it hereby is, stayed for a period of 30 days, commencing on March 21, 1988.

Dated: 3/29/88

/s/ Raymond L. Marsh
Judge of the Superior Court

SUPREME COURT OF CALIFORNIA
IN BANK

S.F. 24242

RICHARD D. KEATING, *et al.*,
Petitioners,

v.

THE SUPERIOR COURT OF ALAMEDA COUNTY,
Respondent.

SOUTHLAND CORPORATION *et al.*,
Real Parties in Interest.

EDWARD J. GOUVEIA *et al.*,
Plaintiffs and Respondents,

v.

SOUTHLAND CORPORATION *et al.*,
Defendants and Appellants.

[And 7 other cases.]*

June 10, 1982

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* *Cheng v. Southland Corporation* (Super.Ct. No. 505162-3); *Newell v. Southland Corporation* (Super.Ct. No. 505164-1); *Sampson v. Southland Corporation* (Super.Ct. No. 505161-4); *Battersby v. Southland Corporation* (Super.Ct. No. 390132); *Keating v. Southland Corporation* (Super.Ct. No. 505159-9); *Coy v. Southland Corporation* (Super.Ct. No. 506120-6); and *Scovis v. Southland Corporation* (Super.Ct. No. C-235779).

McKenna, Conner & Cuneo, McKenna & Fitting, Aaron M. Peck, Charles G. Miller, Martin H. Kresse, Susan L. Carroll, Los Angeles, Arnold & Porter, Peter K. Bleakley, Mark J. Spooner and Peter R. Maier, Washington, D.C., for defendants and appellants and real parties in interest.

Robert M. Brown, Brown & Finney, San Francisco, Brown, Joseph & Finney, Linda R. Joseph, John F. Banker, Banker & Linderman, Tiburon, John F. Wells, Lise A. Pearlman, Fonda Karelitz, D. Barratt Irwin, Stark, Stewart & Simon & Stark, Stewart, Simon & Sparrowe, Oakland, for plaintiffs and respondents and petitioners.

No appearance for respondent.

GRODIN, Justice.**

These coordinated cases arise out of disputes between Southland Corporation (Southland), owner and franchisor of 7-Eleven convenience food store operations throughout the country, and persons who are, or were, franchised operators of 7-Eleven stores in California. The issues before us do not concern the merits of those disputes, but rather the forum and procedure for their resolution. Southland contends that the disputes should be submitted to arbitration on an individual (i.e., franchisee-by-franchisee) basis, pursuant to an arbitration provision contained in its agreement with each franchisee. The franchisees, who have sued Southland [1] in both individual and class actions on a variety of grounds, and who are all represented by the same law firm, contend alternatively that the arbitration provisions are not enforceable on adhesion grounds; that insofar as the

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** Assigned by the Chairperson of the Judicial Council.

[1] The suits also named certain corporate officers as defendants, but as the parties do not distinguish them with respect to the issues presented here, we shall use the term Southland to include both the corporation and its officers.

disputes involve alleged violation by Southland of the Franchise Investment Law they are not subject to arbitration; and that Southland has waived its right to insist upon arbitration in certain of the cases. Franchisees also contend that if there is to be arbitration it should proceed on a classwide, rather than individual, basis. We will hold that the adhesive nature of the franchise contract is not itself a bar to enforcement of the arbitration provision, but that the trial court properly excluded claims based upon alleged violation of the Franchise Investment Law. We will affirm the trial court's holding that there has been no waiver by Southland of its right to insist upon arbitration; but we will remand to the trial court for determination as to whether the interests of justice require that the order to arbitrate be conditioned upon Southland's acceptance of classwide arbitration.

We first describe the factual and procedural background relevant to analysis. Under the terms of Southland's standard 7-Eleven franchise agreement (hereafter the agreement(s)), Southland provides each franchisee with a license to use certain nationally known and federally registered trademarks, a lease or sublease of certain convenience food stores owned or leased by Southland, the financing of store inventories, and advertising and merchandising assistance. The franchisees, in turn, operate the stores, supply Southland with certain bookkeeping data, make bank deposits of receipts from the operation of the stores, and pay Southland a fixed percentage of gross profits. Each of the agreements contains an arbitration clause providing, essentially, that "[a]ny controversy or claim arising out of or relating to this Agreement or the breach thereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . and judgment upon any award rendered by the arbitrator may be entered in any court having jurisdiction thereof."

Between September 1975 and January 1977, franchisees Gouveia, Sampson, Cheng and Newell (and one other franchisee whose claim has since been settled) filed individual actions against Southland alleging, among other things, fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and violation of the disclosure requirements of the Franchise Investment Law (Corp. Code, § 31000 et seq.). In each of these actions except *Gouveia*, Southland filed an answer in which the failure to arbitrate was an affirmative defense, but it took no further steps based on that defense at the time, nor did it actively seek arbitration until after the *Keating* action was filed. In *Gouveia*, *Newell* and *Sampson* it filed cross-complaints, and participated in discovery, including taking the depositions of each of the named plaintiffs.

In May 1977 franchisee Keating filed a class action on behalf of an asserted class composed of approximately 800 Southland franchisees in California, alleging claims substantially similar to those being claimed by the other franchisees, and alleging also that Southland's accounting procedures were unfair and inaccurate. Southland promptly removed *Keating* to the federal district court, and filed an answer and counterclaim to the complaint. A few days later, it filed an amended answer asserting arbitration as a defense. When *Keating* was remanded to the state courts, at franchisees' request, Southland petitioned to compel arbitration in all of the pending cases, but ruling on that petition was stayed pending determination of a motion by the franchisees for coordination of the actions. By this time, the list of actions included a class action filed by franchisee Battersby, and the parties stipulated that *Battersby* would be governed by the rulings in *Keating*.

In November 1977, the motion to coordinate the various actions was granted by the Judicial Council, on condition that franchisees file substantially amended com-

plaints which would demonstrate the asserted similarities among the actions. The amended complaints contain substantially comparable allegations including claims of misrepresentations in connection with the sale of the franchises and inaccurate information about fees, discounts, and the overall performance of 7-Eleven stores.

Except for the claims based on the Franchise Investment Law, the trial court granted Southland's motions to compel arbitration in each of the coordinated actions, without passing upon the franchisees' request for class certification. Southland then appealed from the order to arbitrate insofar as it excluded claims based on the Franchise Investment Law, and the franchisees filed a petition for writ of mandate or prohibition seeking relief from the order to arbitrate on the various grounds stated above. We proceed to consider the issues presented in the order most convenient for discussion. Initially, we observe that since the franchise agreements were between a Texas corporation and California residents, entailed the right to use federally registered trademarks, and contemplated a continuing business relationship between the parties across state lines, they involve interstate commerce and fall within the ambit of the Federal Arbitration Act. (9 U.S.C. § 2.)[2] We shall, therefore, take that statute into account in passing upon the issues presented.

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[2] Section 2 provides: "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract."

I. ADHESION.

In his declaration in opposition to Southland's petition to compel arbitration, Keating stated the franchise agreement was presented to him by Southland representatives on a take-it-or-leave-it basis, with no opportunity to bargain or to negotiate; and that other than the information set forth in the franchise agreement itself, and a pamphlet of the American Arbitration Association describing their procedures, he was "given no verbal or written explanation of the meaning of arbitration, the concept of an arbitration proceeding, the fact that it involved [his] waiver of [his] constitutional rights to a jury trial, a loss of the right to utilize the protection of the courts in the discovery process, nor any information with respect to what arbitration would cost in a procedure of this type." He, and the other franchisees who, in effect, adopt his declaration, contend that the declaration raised questions of fact concerning the enforceability of the arbitration clauses which should have been resolved before arbitration was ordered. The trial court ordered arbitration notwithstanding these contentions. On this score, we find no error.

We accept franchisees' characterization of the franchise agreements, and hence the arbitration agreements, as contracts of adhesion, ". . . 'a standardized contract, which, imposed and drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.'" (*Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 817, 171 Cal.Rptr. 604, 623 P.2d 165, quoting from Justice Tobriner's decision in *Neal v. State Farm Ins. Cos.* (1961) 188 Cal.App.2d 690, 694, 10 Cal.Rptr. 781.) It is undisputed that the franchise agreements in question here are standardized in form, at least as regards the arbitration provision; and that they are drafted and imposed by defendant, a large corporation of vastly superior bargaining strength, upon all parties desiring a

7-Eleven franchise. The California Legislature has determined that franchisees are in need of special protecition in dealing with franchisors. (Corp. Code, § 31001, see generally Corp. Code, § 31000 et seq.)[3] While the franchisees were financially interested in establishing a beneficial business relationship with Southland, and while that interest may not constitute a "needed service" in the sense envisaged in *Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 711, 131 Cal.Rptr. 882, 552 P.2d 1178, or a "service of great importance to the public" as contemplated in *Tunkl v. Regents of University of California* (1963) 60 Cal.2d 92, 99, 32 Cal.Rptr. 33, 383 P.2d 441, it is now clear that those factors are not prerequisite to a finding of adhesion. (*Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d at pp. 818, 820, fn. 18, 171 Cal.Rptr. 604, 623 P.2d 165.)

It does not follow, however, that the contracts are unenforceable. "To describe a contract as adhesive in character is not to indicate its legal effect. It is, rather, 'the

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[3] Corporations Code section 31001 provides, "The Legislature hereby finds and declares that the widespread sale of franchises is a relatively new form of business which has created numerous problems both from an investment and a business point of view . . . . [¶] It is the intent of this law to provide each prospective franchisee with the information necessary to make an intelligent decision regarding franchises being offered. Further, it is the intent of this law . . . to protect the franchisor by providing a better understanding of the relationship between the franchisor and franchisee with regard to their business relationship." (See Damon, *Franchise Investment Law* (1971) (2 Pacific L.J. 27, 27-30, 35-36.) The need for such "special protection" has been recognized in other states and by the federal government who have enacted similar legislation. (15 U.S.C. § 45(a)(1) (1964); Fla.Stat.Ann., § 817.416 (1971) and Rules Chap. 2-17 (1974); Hawaii Rev.Stat., § 482E-1 (1974); Ill.Rev.Stat., ch. 121½, § 702 (1974); Ind.Code, § 23-2-2.5-47 (1975); Mich.Stat.Ann., § 19.854(1) [M.C.L.A. § 445.1501] (1974); Minn.Stat., § 80C.01 (1973); Ore.Rev.Stat., § 650.005, rule 40-050 (1975); R.I.Gen.Laws, § 19-28-2 (1973); Va. Code, § 13.1-558 (1972); Wash.Rev.Code, § 19.100.010 (1972); and Wis.Stat., § 553.01 (1972) Admin. Code, § 31.01.)

beginning and not the end of the analysis insofar as enforceability of its terms is concerned.' [Citation.]" (*Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d at p. 819, 171 Cal.Rptr. 604, 623 P.2d 165.) "Thus, a contract of adhesion is fully enforceable according to its terms [citations] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise." (Id., at pp. 819-820, 171 Cal.Rptr. 604, 623 P.2d 165.) "Generally speaking, there are two judicially imposed limitations on the enforcement of adhesion contracts or provisions thereof. The first is that such a contract or provision which does not fall within the reasonable expectations of the weaker or 'adhering' party will not be enforced against him. [Citations.] The second—a principle of equity applicable to all contracts generally—is that a contract or provision, even if consistent with the reasonable expectations of the parties, will be denied enforcement if, considered in its context, it is unduly oppressive or 'unconscionable.'" (Id., at p. 820, 171 Cal.Rptr. 604, 623 P.2d 165.)

Arbitration in the setting of a contract of adhesion does pose special problems, both because arbitration necessarily entails relinquishment of the constitutional right to trial by jury and because it is susceptible of being structured, or utilized, in such a way as to gain unfair advantage to the party with superior bargaining power. *Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d 807, 171 Cal.Rptr. 604, 623 P.2d 165, in which the agreement called for arbitration by a presumptively partial tribunal, provides an example of that sort of unfairness (see also, *Hope v. Superior Court* (1981) 122 Cal.App.3d 147, 175 Cal.Rptr. 851). As we shall discuss later in this opinion, reliance upon individual arbitration agreements to insulate the stronger party from otherwise appropriate class actions may also be inequitable depending upon the circumstances.

In the absence of some special element of unfair advantage, however, arbitration is generally considered to be a mutually advantageous process, providing for resolution of disputes in a presumptively less costly, more expeditious, and more private manner by an impartial person or persons typically selected by the parties themselves. (See *Madden v. Kaiser Foundation Hospitals*, supra, 17 Cal.3d 699, 131 Cal.Rptr. 882, 552 P.2d 1178.) For these reasons, the fact that provision for arbitration is contained in a contract of adhesion will not, of itself, render the provision unenforceable. (*Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d at pp. 819-820, 171 Cal.Rptr. 604, 623 P.2d 165.)

Moreover, provision for arbitration in a commercial context is quite common, and reasonably to be anticipated. Indeed, Keating's declaration itself makes clear that he was aware of the provision, and of the American Arbitration Association pamphlet making reference to the applicable rules. In such a setting neither he nor the other franchisees are in a position to claim that the arbitration provision itself, or the fact that it would entail waiver of jury trial, lack of formal discovery, or certain costs, did not "fall within [their] reasonable expectations." (*Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d at p. 820, 171 Cal.Rptr. 604, 623 P.2d 165.)

For these reasons, we conclude that the arbitration provisions of the franchise agreement were, in general, binding and enforceable. We proceed now to consider the remaining issues.

II. ARBITRABLITY OF FRANCHISE INVESTMENT LAW CLAIMS.

We next consider Southland's appeal from the trial court's denial of its petitions to compel arbitration concerning certain claims made against it pursuant to the Franchise Investment Law (Corp. Code, § 31000 et seq.). These claims assert, among other things, that Southland

systematically violated section 31202 [4] of the Corporations Code by willfully making untrue statements of material fact, and by willfully omitting to state material facts which are required to be stated in statements required to be disclosed under section 31101.[5] The trial court was apparently of the view that these claims were not subject to arbitration as a matter of contract interpretation and also as a consequence of Corporations Code section 31512, part of the Franchise Investment Law, which provides: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void." Since we agree with the latter conclusion we find it unnecessary to consider the former.

In *Wilko v. Swan* (1953) 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168, the United States Supreme Court interpreted nearly identical language in section 14 of the Securities Act of 1933 (15 15 U.S.C. § 77n)[6] to permit suit by a customer against a securities brokerage firm for alleged misrepresentation in the sale of securities, notwithstanding a provision for arbitration contained in the margin agreement. The arbitration clause, the court decided, constituted a "stipulation," and the right to select the judicial forum the kind of "provision" that could not be waived in advance under section 14. (346 U.S. at pp. 434-435, 74 S.Ct. at p. 186.) In arriving at this con-

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[4] Section 31202 provides: "It is unlawful for any person willfully to make any untrue statement of a material fact in any statement required to be disclosed in writing pursuant to Section 31101, or willfully to omit to state in any such statement any material fact which is required to be stated therein."

[5] Section 31101, subdivision (c) listed some 15 items of information to be disclosed.

[6] That language reads: "Any condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void."

clusion, the court observed that section 12(2) of the act "created a special right to recover for misrepresentation which differs substantially from the common-law action in that the seller is made to assume the burden of proving lack of scienter" (346 U.S. at p. 431, 74 S.Ct. at p. 184), and that this "special right" was enforceable in any court of competent jurisdiction, with a wide choice of venue (ibid.). The court placed primary emphasis, however, upon the proposition that the effectiveness of the statute "is lessened in arbitration as compared to judicial proceedings" (id., at p. 435, 74 S.Ct. at p. 186), in part because of the limited nature of judicial review (id., at p. 436, 74 S.Ct. at p. 187). "As the protective provisions of the Securities Act require the exercise of judicial direction to fairly assure their effectiveness, it seems to us that Congress must have intended [the waiver provision] to apply to waiver of judicial trial and review (id., at p. 437, 74 S.Ct. at p. 188).[7]

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[7] In *Scherk v. Alberto-Culver Co.* (1974) 417 U.S. 506, 94 S.Ct. 2449, 41 L.Ed.2d 270, the Supreme Court declined to apply the *Wilko* rule to a suit under section 10(b) of the Securities Exchange Act of 1934 and rule 10b-5 thereunder, for rescission of a purchase agreement by which Alberto-Culver Co., an American corporation, purchased the trademarks and stock of two foreign corporations. In reaching this conclusion, the court relied primarily on the international character of the transaction, reasoning that "[a] parochial refusal by the courts of one country to enforce an international arbitration agreement would not only frustrate [policies of certainty and predictability], but would invite unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." (Id., at pp. 516-517, 94 S.Ct. at pp. 2446-2447.) While the court made reference to the fact that the Securities Exchange Act did not contain the liberal venue provisions of the Securities Act, and suggested that a "colorable argument" could be made for distinguishing *Wilko* on that ground (id., 417 U.S. at p. 513, 94 S.Ct. at p. 2445), subsequent cases have continued uniformly to apply the *Wilko v. Swan* rule to actions brought by customers against brokerage houses under the Securities Exchange Act, limiting *Scherk* to the arena of international securities transactions. (*Merrill Lynch, Pierce, Fenner & Smith v. Moore* (10th Cir. 1978)

The evidence is persuasive that in drafting the Franchise Investment Law California legislators looked to the Securities Act of 1933 as their model. Not only do the two statutes have the same purpose of protecting investors through preinvestment disclosure statements, but their parallel provisions are often expressed in identical language.[8] Corporations Code section 31301 contains substantially the same provision relating to scienter as the United States Supreme Court relied upon in *Wilko*.[9] And, as we have observed, the waiver language of the two statutes is virtually identical.

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590 F.2d 823; accord, *Mansbach v. Prescott, Ball & Turben* (6th Cir. 1979) 598 F.2d 1017; *Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (7th Cir. 1977) 558 F.2d 831; *Sibley v. Tandy Corp.* (5th Cir. 1977) 543 F.2d 540; *Ayres v. Merrill Lynch, Pierce, Fenner & Smith* (3d Cir. 1976) 538 F.2d 532.) The Second Circuit has suggested that the relatively equal bargaining status of the parties in *Scherk* was also a distinguishing factor. (*Weissbuch v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, supra, 558 F.2d at p. 835; see generally, Gruenbaum, *Avoiding the Protections of the Federal Securities Laws: The Anti-Waiver Provisions* (1980) 20 Santa Clara L.Rev. 49.)

[8] Compare the definition of "sale" under section 2 of the Securities Act (15 U.S.C. § 77b(3)) with that in Corporations Code section 31018; the definition of "misrepresentations by omission" in section 12(2) of the Securities Act (15 U.S.C. § 77l(2)) with Corporations Code section 31201; the burden of proving due diligence of section 11 of the Securities Act (15 U.S.C. § 77k(b)(3)) with Corporations Code section 31301; the provision for injunction actions in section 20 of the Securities Act (15 U.S.C. § 77t(a)) with Corporations Code section 31400; and the liability of control persons of section 15 of the Securities Act (15 U.S.C. § 77o) with Corporations Code section 31302.

[9] Section 31301 provides: "Any person who violates Section 31201 shall be liable to any person (not knowing or having cause to believe that such statement was false or misleading) who, while relying upon such statement shall have purchased a franchise, for damages, unless the defe .dant proves that the plaintiff knew the facts concerning the untruth or omission or that the defendant exercised reasonable care and did not know, (or if he had exercised reasonable care would not have known) of the untruth or omission."

"This court has long recognized the principle of statutory construction that '[w]hen legislation has been judicially construed and a subsequent statute on the same or an analogous subject is framed in the identical language, it will ordinarily be presumed that the Legislature intended that the language as used in the later enactment would be given a like interpretation. This rule is applicable to state statutes which are patterned after the federal statutes. [Citations.]'" (*Belridge Farms v. Agricultural Labor Relations Bd.* (1978) 21 Cal.3d 551, 557, 147 Cal.Rptr. 165, 580 P.2d 665.)

The presumption established by that principle of statutory construction is reinforced by the language and history of the recently adopted California Franchise Relations Act (Bus. & Prof. Code, § 20000 et seq.), regulating the grounds and procedure for termination and nonrenewal of franchises. That statute stemmed from hearings conducted in late 1977 by a subcommittee of the state Assembly Committee on Finance, Insurance, and Commerce, chaired by Assemblyman Bruce Young. A preliminary report prepared by that committee prior to hearings refers to the Franchise Investment Law as a "pre-purchase disclosure law patterned after the Securities Act of 1933," discusses various proposals for extending regulation of franchise relationships, and poses various rhetorical questions in that regard, among them the following: "Present law provides for the resolution of franchisee/franchisor disputes through the judicial system. Should the law be modified to provide for other means of resolution such as compulsory arbitration and/or a Board of Franchising?" [10] The Franchise Relations Act as ultimately adopted by the Legislature contains both a nonwaiver provision nearly identical to Cor-

[10] Assembly Committee on Finance, Insurance, and Commerce, Ad Hoc Subcommittee on Franchising, An Evaluation of the Regulation of Franchising in California and Prospective Legislative Revisions—Background Notes for Interim Study, page 6.

porations Code section 31512 and the following provision authorizing limited arbitrability of disputes under that statute: "Nothing contained in this chapter shall limit the right of a franchisor and franchisee to agree before or after a dispute has arisen to binding arbitration of claims under this chapter, provided that: (a) The standards applied in such arbitration are not less than the requirements specified in this chapter; and (b) The arbitrator or arbitrators employed in such arbitration are chosen from a list of impartial arbitrators supplied by the American Arbitration Association or other impartial person." (Bus. & Prof. Code, § 20040.) The inference is strong, if not inescapable, that the Legislature understood the anti-waiver provision of the Franchise Investment Law to be subject to the *Wilko* (346 U.S. 427, 74 S.Ct. 182, 98 L.Ed.2d 168) interpretation, and that it intended to establish a different rule for the Franchise Relations Act.[11] While we have no evidence as to the policy reasons underlying that distinction, it may be that the Legislature considered arbitration more acceptable in the context of franchise relationships already established, presumably on the basis of proper disclosure, or that it considered the more detailed provisions in the Franchise Investment Law for civil liability (Corp. Code, § 31300), administrative regulation (Corp. Code,

[11] This inference is supported by the following legislative history. Assemblyman Young, who was the author of the bill which became the Franchise Relations Act, sponsored an earlier bill (Assem. Bill No. 944 (1977 Reg. Sess.)) which provided for similar restrictions upon termination of franchises through addition of a new chapter (§ 31220 et seq.) to the Corporations Code. That bill contained a section providing for a similar nonwaiver provision which read as follows: "31224: (a) *Except as provided in subdivision (b) of this section,* any condition, stipulation, provision, or term of any franchise agreement waiving any rights granted under the chapter or relieving any person from liability imposed by this chapter shall be void and unenforceable." (Emphasis added.) Subdivision (b) permitted agreements for "binding arbitration of disputes" subject to the restrictions presently contained in the new law.

§ 31400) and criminal liability (Corp. Code, § 31410 et seq.), to require access to the courts and "the exercise of judicial direction to fairly assure their effectiveness." (*Wilko v. Swan*, supra, 346 U.S. at p. 437, 74 S.Ct. at p. 188.)

Having determined that the California Legislature intended the nonwaiver provision of the California Franchise Act to be interpreted in accord with *Wilko v. Swan*,[12] we turn to Southland's contention that the statute as so construed may not constitutionally be applied to a "contract evidencing a transaction involving commerce" within the meaning of the Federal Arbitration Act (FAA). The argument is that the FAA, in mandating that a provision for arbitration in such a contract "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" (FAA, § 2), establishes a general principle of arbitrability which preempts any state law or policy restrictive of arbitration, whatever the basis for that law or policy might be, and whether or not federal jurisdiction over the underlying controversy exists. We consider that argument overly broad.

The starting point for analysis is *Prima Paint v. Flood & Conklin* (1967) 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed. 2d 1270, in which the Supreme Court held that in a federal court diversity action involving a contract subject to the FAA, a claim of fraud in the inducement of the contract (as distinguished from a claim of fraud in the inducement of the arbitration clause), is a question for the arbitrator, and not the court, to decide; and that this rule applies even though the law of the state in which the contract was to be performed might have a different rule.

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[12] As in *Wilko*, the agreement here was to arbitrate such disputes as might arise in the future. We express no view as to the enforceability of an agreement to arbitrate a pending dispute under the Franchise Investment Law.

The Supreme Court in *Prima Paint* rejected the contention that it was "constitutionally impermissible" to apply the FAA because the case was in the federal court solely by reason of diversity of citizenship. "[T]he question," the court said, "is not whether Congress may fashion federal substantive rules to govern questions arising in simple diversity cases . . . [but] whether Congress may prescribe how *federal* courts are to conduct themselves with respect to subject matter over which Congress plainly has power to legislate." (Id., at p. 405, 87 S.Ct. at p. 1806; emphasis added.) The opinion thus left open the question whether or under what circumstances *state* courts are constitutionally obligated to apply the substantive principles inherent in the federal statute.

Shortly after *Prima Paint* was decided, the New York Court of Appeal indicated it would apply FAA principles to a maritime transaction "even if such a result is not constitutionally mandated by the decision in *Prima Paint*," in order to discourage forum shopping between state and federal courts. (*A/S J. Ludwig Mowinckels R. v. Dow Chem. Co.* (1970) 25 N.Y.2d 576, 307 N.Y.S.2d 660, 666, 255 N.E.2d 774, 778.) Since then a number of courts, both federal and state, have adopted the view that while the FAA is not itself a source of federal jurisdiction, the statute contains certain principles of "substantive federal law" which must be applied, regardless of forum, where federal jurisdiction exists. (E.g., *In re Mercury Const. Corp.* (4th Cir. 1981) 656 F.2d 933, 938; *E. C. Ernst, Inc. v. Manhattan Const. Co. of Texas* (5th Cir. 1977) 551 F.2d 1026, 1040; *Pathman Const. Co. v. Knox County Hospital Ass'n* (1975) 164 Ind.App. 121, 326 N.E.2d 844, 851; *Episcopal Housing Corp. v. Federal Ins. Co.* (1977) 269 S.C. 631, 239 S.E.2d 647; *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal.App.3d 19, 24-25, 136 Cal.Rptr. 378.)

While the federal district court in this case, by its remand, determined that federal jurisdiction over the franchisees' lawsuit did *not* exist, the likely explanation

for that determination is the presence in the case of defendants whose citizenship precludes requisite diversity. Accordingly, we do not decide the preemption issue on that narrow ground (see *In re Mercury Const. Corp.*, supra, 656 F.2d at p. 942).

Rather, we confront squarely the underlying issue of statutory interpretation: whether the principles of "*substantive federal law*" embodied in the FAA, preclude a state from protecting its franchise investors through a system of statutory regulation including nonwaivable judicial remedies. While there is authority for an affirmative answer (*Allison v. Medicab Intern., Inc.* (1979) 92 Wash.2d 199, 597 P.2d 380, 383; *Barron v. Tastee Freez Intern., Inc.* (E.D.Wis. 1980) 482 F.Supp. 1213), we respectfully disagree.

The FAA was adopted in 1925 (43 Stat. 883), against a background of judicial hostility to arbitration generally. (See *Kulukundis Shipping Co. v. Amtorg Trading Corp.* (2d Cir. 1942) 126 F.2d 978, 984; Sayre, *Development of Commercial Arbitration Law* (1927) 37 Yale L.J. 595.) The apparent purpose of the statute was to remove that hostility, and so "make the benefits of arbitration generally available to the business world." (*Robert Lawrence Company v. Devonshire Fabrics, Inc.* (2d Cir. 1959) 271 F.2d 402, 407.) While there is nothing in the legislative history of the statute to suggest that Congress considered its application to state courts (see, Sturges and Murphy, *Some Confusing Matters Relating to Arbitration Under the United States Arbitration Act* (1952) 17 Law & Contemp. Prob. 580, passim), we assume that Congress intended to insulate interstate contracts from judicial hostility regardless of forum (see *Fite & Warmath Const. Co., Inc. v. MYS Corp.* (Ky. 1977) 559 S.W.2d 729), and to establish for such contracts certain uniform rules of interpretation (see *Guinness-Harp Corp. v. Jos. Schlitz Brewing* (2d Cir. 1980) 613 F.2d 468, 472.)

In these respects, California law is entirely in accord. Two years after the FAA was enacted, this state adopted its first modern arbitration statute (Stats.1927, ch. 225), declaring arbitration agreements to be irrevocable and enforceable in terms identical to those used in section 2 of the federal act, and since that time California courts and its Legislature have "consistently reflected a friendly policy toward the arbitration process." (*Kagel*, A Study Relating to Arbitration, in Cal. Law Revision Com. Recommendations and Study Relating to Arbitration (1960) p. G-28.) That policy was expanded and clarified in the current arbitration statute which was adopted in 1961 (Stats.1961, ch. 461, § 2 et seq.), and it continues to be the policy of this state (e.g., *Doers v. Golden Gate Bridge etc. Dist.* (1979) 23 Cal.3d 180, 189, 151 Cal.Rptr. 837, 588 P.2d 1261).

Adoption of an affirmative policy toward enforcement of arbitration agreements has never implied, however, that all types of disputes are subject to arbitration. In New York, for example, one of the earliest states to encourage arbitration through statute, certain categories of disputes are insulated from arbitration as a matter of public policy. (See *Associated Teachers, etc. v. Bd. of Ed.* (1979) 33 N.Y.2d 229 [351 N.Y.S.2d 670, 306 N.E. 2d 791].) Among these are disputes under state antitrust laws, on the ground that "through the use of economic power and contracts of adhesion, containing broad arbitration clauses, antitrust violators may be able to insulate their transgressions of the antitrust law from judicial scrutiny." (*Aimcee Wholesale Corp. v. Tomar Products* (1968) 21 N.Y.2d 621, 629 [289 N.Y.S.2d 968, 973-974, 237 N.E.2d 223, 226-227].) The same is true of matters involving the liquidation of insolvent insurance companies (*Knickerbocker Agency v. Holz* (1958) 4 N.Y.2d 245 [173 N.Y.S.2d 602, 607-610, 149 N.E.2d 885, 889-891]), or the usurious character of a purported

sales agreement (*Durst v. Abrash* (1964) 22 A.D.2d 39, 253 N.Y.S.2d 351, 353).

Such exceptions to the general principle of arbitrability, like those expressed in California's Franchise Investment Law, do not reflect hostility toward arbitration, nor do they constitute an obstacle to the general enforcement of arbitration agreements in a manner consistent with federal law. Rather, such exceptions are narrowly confined to rights and remedies created by state regulatory statutes, and represent a determination that the public interest is best served by maintaining access to the remedies which the Legislature has provided. That Congress intended, through the FAA, to override state policies of that nature seems highly improbable.

The question in this case might be more debatable were it not for the fact that California's policy of protecting judicial remedies for this state's franchise investors was patterned after, and is consistent with, federal policy in the analogous area of securities investment.[13] There is no suggestion that Congress has preempted the field of franchise investor regulation as it has, for example, the field of labor relations (cf. *Teamsters Union v. Oliver* (1959) 358 U.S. 283, 79 S.Ct. 297, 3 L.Ed.2d 312), or that the FAA embodies substantive principles intrinsic to a federally regulated field (cf. *Textile Workers v. Lincoln Mills* (1957) 353 U.S. 448, 77 S.Ct. 923, 1 L.Ed.2d 972). Having left states with power to enact laws in this area, it is hardly likely that Congress intended to preclude them from adopting policies which Congress itself has found to be appropriate.[14]

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[13] We observe that California's Corporate Securities Law contains a substantially identical nonwaiver provision (Corp. Code, § 25701). Southland's argument would preclude its application to interstate transactions as well.

[14] Southland observes that two federal statutes which regulate franchise relationships Petroleum Marketing Practices Act (15 U.S.C. § 2801 et seq.) and Automobile Dealer Suits Against Manu-

Preemption principles were recently summarized by the United States Supreme Court in *Merrill Lynch, Pierce, Fenner & Smith v. Ware* (1973) 414 U.S. 117, 94 S.Ct. 383, 38 L.Ed.2d 348, holding that California's statutory policy excluding wage claims from arbitration (Lab. Code, § 229) was not preempted by rules promulgated by the New York Stock Exchange pursuant to federal law: " 'The principle to be derived from our decisions is that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained.' [Citation.] [¶] In other contexts, preemption has been measured by whether the state statute frustrates any part of the purpose of the federal legislation. [Citations.] And . . . while prior cases on preemption 'are not precise guidelines,' because each case turns on the peculiarities and special features of the federal regulatory scheme in question, it is where there is in existence a pervasive and comprehensive scheme of federal regulation that pre-emption follows in order to fulfill the federal statutory purposes. [Citations.] [¶] In the area of regulation that we are considering here, California has manifested a strong policy of protecting its wage earners from what it regards as undesirable economic pressures affecting the employment relationship. This policy prevails in the absence of interference with the federal regulatory scheme. We find no such interference . . . ." (414 U.S. at pp. 139-140, 94 S.Ct. at pp. 395-396.)

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facturers (15 U.S.C. § 1221 et seq.), do not contain provisions similar to 15 United States Code section 77n. Neither of these statutes imposes analogous disclosure requirements, however, nor has the issue of arbitrability of disputes under them been litigated in reported cases.

The court in *Ware* did not consider the applicability of the FAA, and the holding in the case is consequently not controlling here, but the principles which the court announced strongly support rejection of Southland's argument. Not only has California "manifested a strong policy of protecting its [franchise investors] from what it regards as undesirable economic pressures affecting the [franchise] relationship" (ibid.), it has done so through a regulatory scheme containing remedies which it has deemed appropriate to protect against waiver, and in accordance with policies compatible with the pattern of federal regulation.

The United States Supreme Court has "repeatedly warned against the dangers of an approach to statutory construction which confines itself to the bare words of a statute, [citations], for 'literalness may strangle meaning.' [Citation]." (*Lynch v. Overholser* (1962) 369 U.S. 705, 710, 82 S.Ct. 1063, 1067, 8 L.Ed.2d 211.) We accept that the FAA contains certain principles of substantive federal law which must be applied, regardless of forum, where federal jurisdiction exists; on that point we are fully in accord with our dissenting colleagues. We simply reject Southland's argument that those principles are so unyielding as to require enforcement of an agreement to arbitrate a dispute over the application of a regulatory statute which a state legislature, in conformity with analogous federal policy, has decided should be left to judicial enforcement.[15]

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[15] Southland urges that exclusion of Franchise Investment Law claims from arbitration will lead to duplicative proceedings because franchisees' common law claims of fraud and negligent misrepresentation involve the "same constellation of facts." Under federal law, such considerations may be taken into account in determining the order of proceedings, and even in determining whether common law claims should be decided in a judicial forum. (*Sibley v. Tandy Corp.*, supra, 543 F.2d 540, 543, cert. den. (1977) 434 U.S. 824, 98 S.Ct. 71, 54 L.Ed.2d 82; *Miley v. Oppenheimer & Co., Inc.* (5th Cir. 1981) 637 F.2d 318.)

III. WAIVER.

Franchisees contend that Southland waived its right to arbitration by delays in asserting it, and by pursuing legal actions which were inconsistent with it. We will separately consider waiver in connection with *Keating*, and with the individual actions.

The law in this area is rather well defined. Arbitration is strongly favored. Courts will closely scrutinize any claims of waiver (*Gavlik Const. Co. v. H. F. Campbell Co.* (3d Cir. 1975) 526 F.2d 777, 783; *Seidman & Seidman v. Wolfson* (1975) 50 Cal. App.3d 826, 835, 123 Cal.Rptr. 873; 9 U.S.C. § 3; Code Civ.Proc., § 1281.2, subd. (a)), and " 'indulge every intendment to give effect to such proceedings.' (*Pacific Inv. Co. v. Townsend* (1976) 58 Cal.App.3d 1, 9 [129 Cal.Rptr. 489].)" (*Doers v. Golden Gate Bridge etc. Dist.*, supra, 23 Cal.3d 180, 189, 151 Cal.Rptr. 837, 588 P.2d 1261.) Moreover, the burden of proof is "heavy" and rests on the party seeking to establish waiver (*Martin Marietta Aluminum, Inc. v. General Elec. Co.* (9th Cir. 1978) 586 F.2d 143, 146; *General Guar. Ins. Co. v. New Orleans General Agency, Inc.* (5th Cir. 1970) 427 F.2d 924, 929, fn. 5) which "is not to be lightly inferred." (*Gavlik Const. Co.* v. *H. F. Campbell Co.*, supra, 526 F.2d at p. 783; *Davis v. Blue Cross of Northern California* (1979) 25 Cal.3d 418, 426, 158 Cal.Rptr. 828, 600 P.2d 1060.)

The trial court here found no waiver. Because the question of waiver is one of fact, we have noted that the "determination of this question, if supported by substantial evidence, is binding on an appellate court. [Citation.] . . . [it is only] in cases where the record before the trial court establishes a lack of waiver as a matter of law, [that] the appellate court may reverse a finding of waiver made by the trial court." (*Doers v. Golden Gate Bridge etc. Dist.*, supra, 23 Cal.3d at p. 185, 151 Cal. Rptr. 837, 588 P.2d 1261; see *Reid Burton Const. v. Carpenters Dist. Council, etc.* (10th Cir. 1980) 614 F.2d

698, 703, cert. den. (1980) 449 U.S. 824, 101 S.Ct. 85, 66 L.Ed.2d 27 [adopting a "clearly erroneous" standard of review].)

We have recently acknowledged that while there is no "single test" in establishing waiver, the relevant factors include whether the party seeking arbitration (1) has "previously taken steps inconsistent with an intent to invoke arbitration," (2) "has unreasonably delayed" in seeking arbitration, (3) or has acted in "bad faith" or with "wilful misconduct." (*Davis v. Blue Cross of Northern California*, supra, 25 Cal.3d at pp. 425-426, 158 Cal. Rptr. 828, 600 P.2d 1060; see *Germany v. River Terminal Railway Company* (6th Cir. 1973) 477 F.2d 546, 547.) We have stressed the significance of the presence or absence of prejudice. Waiver does not occur by mere participation in litigation; there must be "judicial *litigation* of the merits of arbitrable issues" (*Doers v. Golden Gate Bridge etc. Dist.*, supra, 23 Cal.3d at p. 188, 151 Cal.Rptr. 837, 588 P.2d 1261), although "waiver could occur prior to a judgment on the merits if prejudice could be demonstrated" (id., at p. 188, fn. 3, 151 Cal. Rptr. 837, 588 P.2d 1261). This result is fully consistent with federal cases which have held that "as an abstract exercise in logic it may appear that it is inconsistent for a party to participate in a lawsuit for breach of a contract, and later to ask the court to stay that litigation pending arbitration. Yet the law is clear that such participation, standing alone, does not constitute a waiver [citations], for there is an overriding federal policy favoring arbitration. . . . [M]ere delay in seeking a stay of the proceedings without some resultant prejudice to a party [citation], cannot carry the day." (*Carcich v. Rederi A/B Nordie* (2d Cir. 1968) 389 F.2d 692, 696; see *Shinto Shipping Co. v. Fibrex & Shipping Co., Inc.* (9th Cir. 1978) 572 F.2d 1328, 1330.)

Tested by these principles, the record fully supports the trial court's conclusion that there was no waiver in *Keating*. Southland had a legal right to petition for re-

moval of the case to the federal district court; it did so promptly, as the statute requires (28 U.S.C. § 1446(b)); and in its amended pleading it asserted the arbitration agreement as a defense. Prior to remand, the only discovery which took place consisted of an exchange of documents to franchisees' benefit. Upon remand, Southland moved promptly to compel arbitration.[16] We discern no impropriety on the part of Southland, or prejudice to franchisees, in these brief transactions.

In the remaining four individual actions, namely, *Gouveia*, *Sampson*, *Cheng*, and *Newell*, the trial court granted the motions to arbitrate except as to the Franchise Investment Law claims, and stayed the proceedings pending completion of arbitration. In noting the coordination of the various actions the court observed that "there are matters which would otherwise be arbitrable which are raised for the first time in the second amended complaint." It believed that referring to arbitration only some issues while retaining others might well achieve inconsistent results and would serve no useful purpose. The court also observed that in some cases, separately viewed, "there more than likely would have been found to be a waiver."

Franchisees interpret the foregoing trial court remarks as constituting a holding of waiver. They also contend that the trial court erred in misconstruing the coordination of the proceedings as requiring complete consistency of result between the individual cases. We do not agree. Extensively amended complaints have been filed in each case after the actions had been coordinated at franchisees' request. We cannot say, as a matter of law, that the court erroneously considered the coordinated posture of the cases in finding a lack of waiver of Southland's right to arbitration. Franchisees themselves asserted in their motion for coordination that "[e]ach of the actions

[16] It moved also for a change of venue, which was granted by stipulation.

for which coordination is sought herein is at the same relative stage of development." Furthermore, the court did not specify in which of the actions a waiver might have appeared, and franchisees' argument that the trial court found a waiver in any individual case is purely speculative.

Moreover, assuming a waiver had occurred as to the charging allegations in the original complaints, such waiver would not extend to issues newly raised. (Cf. *Janmort Leas., Inc. v. Econo-Car Intern.* (E.D.N.Y. 1979) 475 F. Supp. 1282, 1290.) In seeking coordination and amendment of their complaints, franchisees considerably expanded the scope of their pleadings, raising several new causes of action, injecting new factual elements, and refocusing the direction of their claims. We do not suggest that an amendment to a complaint will, per se, nullify a previous, effective waiver of arbitration in every case. Here, however, franchisees directed a newly concerted attack, evidenced by the filing of amended complaints and the motion to coordinate. This sufficiently changed the proceedings, when viewed in their entirety, to permit the trial court to find a lack of waiver of the right to arbitrate the closely interrelated and interdependent claims.

We are unable to accept franchisees' argument that any waiver occurred because of Southland's litigation-related activities in *Gouveia*, *Sampson*, *Cheng*, and *Newell*. As with similar arguments advanced with reference to the *Keating* complaint, Southland's delay in seeking arbitration of the other complaints, its filing of counterclaims and actions for unlawful detainer, and its participation in discovery did not require a finding of waiver. (*Doers v. Golden Gate Bridge etc. Dist.*, supra, 23 Cal.3d at p. 188, 151 Cal.Rptr. 837, 588 P.2d 1261; *Carcich v. Rederi A/B Nordie*, supra, 389 F.2d at p. 696.) Here, Southland raised arbitration as an affirmative defense in its answers to each of the original complaints except in

Gouveia. As previously noted, "it is the judicial *litigation* of the merits of arbitrable disputes which waives a party's right to arbitration" (*Doers v. Golden Gate Bridge etc. Dist.*, supra, 23 Cal.3d at p. 188, 151 Cal. Rptr. 837, 588 P.2d 1261), and the burden is on franchisees to show that the trial court's determination was not supported by the facts. (See, e.g., *Hart v. Orion Insurance Company* (10th Cir. 1971) 453 F.2d 1358, 1361.)

Because of the mandatory nature of Code of Civil Procedure section 426.30 requiring that any related cause of action be alleged, no waiver arose by reason of the filing of the cross-complaints. As to the unlawful detainer causes of action, the agreements themselves specifically provide that a demand for arbitration "shall not operate to stay . . . the right of 7-Eleven to take possession of the Lease Property in accordance with the Agreement." The contract contemplated that arbitration and litigation of the right to possession would proceed simultaneously.

Again, we find most significance in the lack of any prejudice demonstrated by franchisees in *Gouveia*, *Sampson*, *Cheng*, and *Newell*. While Southland participated in discovery in the individual actions before demanding arbitration, the trial court expressly conditioned its order to compel arbitration on Southland's agreement either to abstain from the use of further discovery or to extend equally extensive discovery to franchisees. Moreover, the discovery was reciprocal; for example, franchisees' petition for coordination indicated that evidence of Southland's bookkeeping practices had already been obtained and was relevant to all of the individual actions.

Neither side had completed its discovery, and Southland asserted, without refutation, that the filing of the new complaints significantly raised new issues requiring further discovery should the cases go to trial. The condition imposed by the trial court on its order for arbitration, however, prevented Southland from taking advantage of any previously discovered information.

Our function is to determine whether the trial court's finding of no waiver is supported by substantial evidence. Franchisees have not made specific claims of prejudice. Nor have we been supplied with any record of the discovery proceedings already undertaken by which we could independently assess such claims if made.

Accordingly, we cannot conclude that the trial court erred in finding no waiver and in ordering arbitration.

IV. CLASS ARBITRATION.

The trial court, in ordering arbitration, did not expressly rule upon the motions in *Keating* and *Battersby* for class certification. Franchisees contend that if arbitration is to proceed the trial court should be instructed to determine the preliminary issues regarding class certification so that it may proceed on a classwide basis. This contention requires us to examine the special problems of unfair advantage which may appear in an adhesion setting when individual arbitration agreements are invoked to block an otherwise appropriate class action.[17]

This court has repeatedly emphasized the importance of the class action device for vindicating rights asserted by large groups of persons. We have observed that the class suit "both eliminates the possibility of repetitious litigation and provides small claimants with a method of obtaining redress for claims which would otherwise be too small to warrant individual litigation. [Citation.]" (*Richmond v. Dart Industries, Inc.* (1981) 29 Cal.3d 462, 469, 174 Cal.Rptr. 515, 629 P.2d 23.) Denial of a class action in cases where it is appropriate may have the effect of allowing an unscrupulous wrongdoer to "re-

[17] We assume, for purposes of this analysis, that *Keating* and *Battersby* would be maintainable as class actions under established principles, but we intimate no opinion as to whether that is, in fact, the case. That will be an issue for the trial court upon remand.

tain[] the benefits of its wrongful conduct." (*Vasquez v. Superior Court* (1971) 4 Cal.3d 800, 808, 94 Cal.Rptr. 796, 484 P.2d 964.)[18] And, as we noted in *LaSala v. American Sav. & Loan Assn.* (1971) 5 Cal.3d 864, 877, 97 Cal.Rptr. 849, 489 P.2d 1113: "Controversies involving widely used contracts of adhesion present ideal cases for class adjudication; the contracts are uniform, the same principles of interpretation apply to each contract, and all members of the class will share a common interest in the interpretation of an agreement to which each is a party."

If the right to a classwide proceeding could be automatically eliminated in relationships governed by adhesion contracts through the inclusion of a provision for arbitration, the potential for undercutting these class action principles, and for chilling the effective protection of interests common to a group, would be substantial. Arbitration proceedings may well provide certain offsetting advantages through savings of time and expense; but, depending upon the nature of the issues and the evidence to be presented, it is at least doubtful that such advantages could compensate for the unfairness inherent in forcing hundreds or perhaps thousands, of individuals asserting claims involving common issues of fact and law to litigate them in separate proceedings against a party with vastly superior resources. Because the principles of res judicata and collateral estoppel do not apply in arbitration proceedings, any issue resolved against a party such as Southland in one arbitration proceeding would have to be decided anew in a subsequent arbitration, re-

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[18] Federal law is in accord. (See, e.g., *Weeks v. Bareco Oil Co.* (7th Cir. 1941) 125 F.2d 84, 90 ("To permit the defendants to contest liability with each claimant in a single, separate suit, would, in many cases give defendants an advantage which would be almost equivalent to closing the door of justice to all small claimants"); *Moscarelli v. Stamm* (E.D.N.Y. 1968) 288 F. Supp. 453, 461.)

sulting in needless duplication and the potential for inconsistent awards. And while arbitration ideally takes place outside the judicial arena, it would be naive to assume, in such a situation, that courts would not be called upon to determine issues ancillarly to the arbitration proceedings. The effect would be to place upon the parties, and upon the courts, many of the burdens which the class action device was designed to avoid.

It is common knowledge that arbitration clauses frequently appear in standardized contracts of adhesion. A primary consideration which has led courts to uphold such clauses, despite the adhesive nature of the contract, is the belief that arbitration is not oppressive and does not defeat the reasonable expectations of the parties. (*Madden v. Kaiser Foundation Hospitals*, supra, 17 Cal. 3d 699, 710, 712, 131 Cal.Rptr. 882, 552 P.2d 1178.) If, however, an arbitration clause may be used to insulate the drafter of an adhesive contract from any form of class proceeding, effectively foreclosing many individual claims, it may well be oppressive and may defeat the expectations of the nondrafting party.

One possible solution to this dilemma would be to hold that arbitration agreements contained in contracts of adhesion may not operate to stay properly maintainable class actions. (See *Harris v. Shearson Hayden Stone, Inc.* (1981) 82 A.D.2d 87, 441 N.Y.S.2d 70, 76-79 (dis. opns.); cf. *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1971) 20 Cal.App.3d 668, 672, 97 Cal.Rptr. 811; *Vernon v. Drexel Burnham & Co.* (1975) 52 Cal. App.3d 706, 125 Cal.Rptr. 147.) The statutes and public policy supportive of arbitration require, however, that this result be avoided if means are available to give expression to the basic arbitration commitment of the parties. (*Graham v. Scissor-Tail, Inc.*, supra, 28 Cal.3d 807, 831, 171 Cal.Rptr. 604, 623 P.2d 165.) We turn our attention, therefore, to the solution offered by franchisees: that the arbitration itself proceed on a classwide basis.

There is, as the parties acknowledge, an absence of direct authority either supporting or rejecting such a procedure. Analogous authority exists, however, with respect to the consolidation of arbitration proceedings involving a dispute which concerns several parties each of whom has an agreement with one or more of the others to arbitrate the dispute. "Although the [Federal Arbitration] Act does not specifically provide for consolidated arbitrations, courts have frequently ordered consolidated arbitration proceedings when the 'interests of justice' so require, either because the issues in dispute are substantially the same and/or because a substantial right might be prejudiced if separate arbitration proceedings are conducted." (*Matter of Czarnikow-Rionda Co., Inc.* (S.D.N.Y.1981) 512 F.Supp. 1308, 1309.) Indeed, the Second Circuit has opined that "the liberal purposes of the Federal Arbitration Act clearly require that this act be interpreted so as to permit and even encourage the consolidation of arbitration proceedings in proper cases." (*Compania Espanola de Pet., S.A. v. Nereus Ship*, (2d Cir. 1975) 527 F.2d 966, 975, cert. den. (1976) 426 U.S. 936, 96 S.Ct. 2650, 49 L.Ed.2d 387; see also, *Marine Trading Ltd. v. Ore International Corp.* (S.D.N.Y.1977) 432 F.Supp. 683; *Robinson v. Warner* (D.C.R.I.1974) 370 F.Supp. 828.)

Federal courts, in ordering consolidation of arbitration proceedings in these cases, have relied upon rule 81(a)(3) of the Federal Rules of Civil Procedure, which states that the federal rules apply to certain statutes, including the FAA, "only to the extent that matters of procedure are not provided for in those statutes." Thus, rule 42(a), which provides for consolidation of related proceedings, is deemed to apply. Analogous reasoning would support reliance on rule 23, the class action rule, as a basis for ordering classwide arbitrations when the interests of justice so require.

A number of state courts also support consolidation of arbitration proceedings, even in the absence of express

statutory authority. New York courts take the position that "jurisdiction to enforce contracts to arbitrate imports power to regulate the method of enforcement." (*Chariot Textiles Corp. v. Wannalancit Textile Co.* (1964) 21 A.D.2d 762, 250 N.Y.S.2d 493, 495 (dis. opn.), revd. on dis. opn. (1966) 18 N.Y.2d 793, 275 N.Y.S.2d 382, 221 N.E.2d 913 [221 N.E.2d 913]; see also *In re Vigo Steamship Corporation* (1970) 26 N.Y.2d 157, 257 N.E.2d 624,, cert. den. *sub nom., Frederick Snare Corp. v. Vigo Steamship Corp.* (1970) 400 U.S. 819, 91 S.Ct. 36, 27 L.Ed.2d 46; accord: *Grover-Dimond Assoc. v. American Arbitration Ass'n* (1973) 297 Minn. 324, 211 N.W.2d 787; see also, *Exber, Inc. v. Sletten Construction Company* (1976) 92 Nev. 721, 558 P.2d 517; *James Stewart Polshek, etc. v. Bergen Iron Wks.* (1976) 142 N.J.Super. 516, 362 A.2d 63; *Episcopal Housing Corp. v. Federal Ins. Co.* (1979) 273 S.C. 181, 255 S.E.2d 451; contra: *Stop & Shop Companies, Inc. v. Gilbane Building Co.* (1973) 364 Mass. 325, 304 N.E.2d 429; *J. Brodie & Son, Inc. v. George A. Fuller Company* (1969) 16 Mich. App. 137, 167 N.W.2d 886; see generally, Annot., Consolidation of Arbitration Proceedings, 64 A.L.R.3d 528, 529.) In California, consolidation in certain cases is expressly authorized by statute. (Code Civ.Proc., § 1281.3.) [19]

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[19] Section 1281.3 was added in 1978 (Stats. 1978, ch. 260, § 2), apparently in response to a Court of Appeal decision holding that courts of this state lacked authority to order consolidation of arbitration proceedings. (*Atlas Plastering, Inc. v. Superior Court* (1977) 72 Cal.App.3d 63, 140 Cal.Rptr. 59.) The section permits consolidation of separate arbitration proceedings when "(1) Separate arbitration agreements or proceedings exist between the same parties; or one party is a party to a separate arbitration agreement or proceeding with a third party; and (2) The disputes arise from the same transactions or series of related transactions; and (3) There is common issue or issues of law or fact creating the possibility of conflicting rulings by more than one arbitrator or panel of arbitrators."

Consolidated arbitration often involves a tripartite relationship in which the parties in dispute each have a contract with a third party, but not with each other. Each contract may provide a different procedure for arbitration, or a different method of selecting the arbitrator. Federal courts have held that a court "can mold the method of selection and the number of arbitrators to implement the consolidated proceedings." (*Matter of Czarnikow-Rionda Co., Inc.*, supra, 512 F.Supp. at p. 1309.) Similarly, Code of Civil Procedure section 1281.3 provides that consolidated arbitration proceedings may be ordered inter alia, where "one party is a party to a separate arbitration agreement or proceeding with a third party," and that if the agreements do not mesh in their description of procedure, a court has authority to appoint an arbitrator, and to "resolve [conflicts among the agreements] and determine the rights and duties of the various parties to achieve substantial justice under all the circumstances." Thus, a party may be forced into a coordinated arbitration proceeding in a dispute with a party with whom he has no agreement, before an arbitrator he had no voice in selecting and by a procedure he did not agree to.

In these respects, an order for classwide arbitration in an adhesion context would call for considerably less intrusion upon the contractual aspects of the relationship. The members of a class subject to classwide arbitration would all be parties to an agreement with the party against whom their claim is asserted; each of those agreements would contain substantially the same arbitration provision; and if any of the members of the class were dissatisfied with the class representative, or with the choice of arbitrator, or for any other reason would prefer to arbitrate on their own, they would be free to opt out and do so. Moreover, the interests of justice that would be served by ordering classwide arbitration are likely to be even more substantial in some cases than the interests that are thought to justify consolidation. It is unlikely

that the state Legislature in adopting the amendment to the Arbitration Act authorizing consolidation of arbitration proceedings, intended to preclude a court from ordering classwide arbitration in an appropriate case. We conclude that a court is not without authority to do so.

Without doubt a judicially ordered classwide arbitration would entail a greater degree of judicial involvement than is normally associated with arbitration, ideally "a complete proceeding, without resort to court facilities." (*East San Bernardino County Water Dist. v. City of San Bernardino* (1973) 33 Cal.App.3d 942, 950, 109 Cal.Rptr. 510.) The court would have to make initial determinations regarding certification and notice to the class, and if classwide arbitration proceeds it may be called upon to exercise a measure of external supervision in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement. A good deal of care, and ingenuity, would be required to avoid judicial intrusion upon the merits of the dispute, or upon the conduct of the proceedings themselves and to minimize complexity, costs, or delay. (See *Class Wide Arbitration: Efficient Adjudication or Procedural Quagmire?* (1981) 67 Va.L.Rev. 789.)

An adhesion contract is not a normal arbitration setting, however, and what is at stake is not some abstract institutional interest but the interests of the affected parties. Classwide arbitration, as Sir Winston Churchill said of democracy, must be evaluated, not in relation to some ideal but in relation to its alternatives. If the alternative in a case of this sort is to force hundreds of individual franchisees each to litigate its cause with Southland in a separate arbitral forum, then the prospect of classwide arbitration, for all its difficulties, may offer a better, more efficient, and fairer solution. Where that is so, and gross unfairness would result from the denial of opportunity to proceed on a classwide basis, then an order structuring arbitration on that basis would be justified.

Whether such an order would be justified in a case of this sort is a question appropriately left to the discretion of the trial court. In making that determination, the trial court would be called upon to consider, not only the factors normally relevant to class certification, but the special characteristics of arbitration as well, including the impact upon an arbitration proceeding of whatever court supervision might be required, and the availability of consolidation as an alternative means of assuring fairness. Whether classwide proceedings would prejudice the legitimate interests of the party which drafted the adhesion agreement must also be considered, and that party should be given the option of remaining in court rather than submitting to classwide arbitration.

In this case, the trial court did not consider the franchisees' request for classwide arbitration at all, and a fortiori did not consider the factors which we have found to be relevant. Since we are unable to make the determination on this record as a matter of law, the case will be remanded to the trial court on this issue.

The order of the trial court is reversed and the cause is remanded for further proceedings consistent with the opinion herein. In light of our opinion, the petition for writ of prohibition or mandate is denied. Each party to bear their own costs.

BIRD, C. J., and NEWMAN and REYNOSO, JJ., concur.

RICHARDSON, Justice, concurring and dissenting.

I concur with the majority's conclusions that the arbitration agreement is enforceable and that Southland did not waive its right to arbitration. I respectfully dissent, however, from the majority's further holdings that the Franchise Investment Law claims are not subject to arbitration and that class action arbitration is an available valid remedy.

A. ARBITRABILITY OF THE FRANCHISE INVESTMENT LAW CLAIMS

Contrary to the majority, I believe that the state cannot immunize certain civil actions from application of the Federal Arbitration Act merely by fashioning, after the Federal Securities Act, a statute regulating franchise investments.

The United States Supreme Court in *Wilko v. Swan* (1953) 346 U.S. 427, 74 S.Ct. 182, 98 L.Ed. 168, held that an arbitration clause contained in a margin agreement was invalid as a forbidden "stipulation" under section 14 of the federal Securities Act of 1933. (15 U.S.C. § 77n.) In so holding, the court observed that two statutory policies were invoked: (1) the Federal Arbitration Act's emphasis on "the need for avoiding the delay and expense of litigation" (*id.*, at p. 431, 74 S.Ct. at p. 184, fn. omitted); and (2) the Securities Act's purpose to protect investors by requiring "full and fair disclosure . . . and to prevent fraud." (*Ibid.*) The high court stressed that "[w]hen the security buyer, prior to any violation of the Securities Act, waives his right to sue in courts, he gives up more than would a participant in other business transactions. The security buyer has a wider choice of courts and venue. He thus surrenders one of the advantages the Act gives him and surrenders it at a time when he is less able to judge the weight of the handicap the Securities Act places upon his adversary." (*Id.*, at p. 435, 74 S.Ct. at p. 186.) In measuring the force of the two policies, the *Wilko* court thus was required to balance two *federal* statutes, the Arbitration and the Securities Acts.

The *Wilko* court identified one important factor in the weighing process, namely, the existence of 15 United States Code section 77v, which establishes an unusually liberal venue provision for Securities Act litigation. This emphasis on venue was subsequently repeated in *Scherk v. Alberto-Culver Co.* (1974) 417 U.S. 506, 94 S.Ct. 2449,

41 L.Ed.2d 270, in which the high court *declined* to invalidate an arbitration clause in a controversy between foreign and domestic parties concerning an alleged violation of the 1934 Securities Exchange Act. The *Scherk* court specifically emphasized that the 1934 Act's venue provision (15 U.S.C. § 78aa) "significantly restrict[s] the plaintiff's choice of forum" in contrast to section 77v, upon which the court "in particular" relied in *Wilko v. Swan.* (*Id.*, 417 U.S. at p. 514, 94 S.Ct. at p. 2454, fn. omitted.)

In contrast, the case before us concerns a *state* statute which is contrary to the *federal* law. The *Wilko* reasoning in balancing between two federal statutes of equal stature thus is not required here. Moreover, unlike the Securities Act of 1933, the state Franchise Investment Law at issue here does not contain a liberal venue provision comparable to that relied on in *Wilko.* Thus, under the California statute an investor who consents to arbitration, thereby waiving the right to sue, does *not* forgo more than other similarly situated parties to routine business contracts or transactions.

No different result is mandated by section 31512 of the Corporations Code, which provides that "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provisions of this law or any rule or order hereunder is void." Even if the Legislature had intended that this statute be interpreted according to the principles of *Wilko v. Swan,* the section nonetheless impermissibly conflicts with the Federal Arbitration Act. Section 31512 is therefore void under the supremacy clause (U.S.Const., art. VI, § 2) to the extent that it purports to restrict otherwise permissible arbitration in actions, as here, involving interstate commerce.

In reaching its conclusion that application of the Federal Arbitration Act here is not required, the majority

wholly ignores a substantial line of very respectable authority. These cases, as I now develop, hold that in enacting the Federal Arbitration Act, Congress created *national substantive law*, which is binding on state courts even in the absence of federal jurisdiction.

In 1959, the United States Court of Appeals for the Second Circuit succinctly expressed the general principle. "We think it is reasonably clear that the Congress intended by the Arbitration Act to create *a new body of federal substantive law* affecting the validity and interpretation of arbitration agreements." (*Robert Lawrence Company v. Devonshire Fabrics, Inc.* (2d Cir. 1959) 271 F.2d 402, 406, cert. dism. (1960) 364 U.S. 801, 81 S.Ct. 27, 5 L.Ed.2d 37, italics added.) The *Lawrence* court observed: "To be sure much of the Act is purely procedural in character and is intended to be applicable only in the federal courts. But Section 2 declaring that arbitration agreements affecting commerce or maritime affairs are 'valid, irrevocable, and enforceable' goes beyond this point and must mean that arbitration agreements of this character, previously held by state law to be invalid, revocable, or unenforceable are now made 'valid, irrevocable, and enforceable.' *This is a declaration of national law equally applicable in state or federal courts.*" (*Id.*, at p. 407, italics added.)

The United States Supreme Court has acknowledged the *Lawrence* holding only in one instance, where it merely note that the Court of Appeals in the case it was then considering had relied upon the *Lawrence* notion of "national substantive law" to hold that "a claim of fraud in the inducement of the contract generally—as opposed to the arbitration clause itself—is for the arbitrators and not for the courts . . . ." (*Prima Paint v. Flood & Conklin* (1967) 388 U.S. 395, 399-400, 87 S.Ct. 1801, 1803-1804, 18 L.Ed.2d 1270.) The high tribunal then affirmed the decision below, "albeit for somewhat different reasons." (*Ibid.*) Thus the Supreme

Court has never rejected the long standing doctrine that the Arbitration Act created national substantive law applicable in appropriate circumstances in state courts.

The great majority of lower federal and state courts has continued to adhere to the *Lawrence* holding. (See Annot. (1979) 95 A.L.R.3d 1145, 1151-1161.) A recent expression of this principle is contained in *In re Mercury Const. Corp.* (4th Cir. 1981) 656 F.2d 933 (en banc) (cert. granted *sub nom. Moses A. Cone Memorial Hospital v. Mercury Const. Corp.* (1982) —— U.S. —— [102 S.Ct. 1426, 71 L.Ed.2d 647]) (three questions were presented in the petition for certiorari; none specifically concerns the scope of the Arbitration Act although one involves the district court's discretion to stay its proceedings pending resolution of identical issues in a state court action involving identical parties). In discussing the application of the Federal Arbitration Act to state and federal actions the Fourth Circuit noted: "By its express language the Federal Act applies where there is '[a] written provision . . . in a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract . . . .'" 9 U.S.C. § 2. The constitutional validity of such an Act is found in the incontestable federal control over interstate commerce. *Prima Paint v. Flood & Conklin*, 388 U.S. 395, 405, 87 S.Ct. 1801, 1806, 18 L.Ed.2d 1270 . . . . The Act, however, does not include language conferring independent federal jurisdiction over an action thereunder. In order for a plaintiff to assert rights under it in a federal forum, he must establish an independent jurisdictional basis, such as diversity. [Citations.] But if, assuming diversity of the parties, the action meets the jurisdictional requirements of the Act, that action is enforceable in the state courts as well as in federal courts but *in either event it is governed by the federal substantive law developed in connection with the federal Act and not by state law. E.C. Ernst, Inc. v. Manhattan Const.*

Co., 551 F.2d 1026, 1040 (5th Cir. 1977) (any questions under the Act are matters of 'federal law'); *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, supra, 271 F.2d at 406; *Pathman Const. Co. v. Knox County Hospital Ass'n.*, 164 Ind.App. 121, 326 N.E.2d 844, 851 (1975); *Episcopal Housing Corp. v. Federal Ins. Co.*, 269 S.C. 631, 636, 239 S.E.2d 647 (1977)." (*Id.*, at p. 938, italics in original, fn. omitted.) As described in *Lawrence*, Congress in enacting the arbitration act sought to counteract the hostility of courts and judges to arbitration agreements and to "make the benefits of arbitration generally available to the business world." (271 F.2d at pp. 406-407; see *Prima Paint v. Flood & Conklin*, supra, 388 U.S. at p. 405, 87 S.Ct. at p. 1806 [Congress "plainly" had power to legislate over arbitration].)

Despite the majority's recognition of the large body of law holding that the act is applicable in state courts in appropriate cases, my colleagues seek to create, judicially, an exception for certain state regulatory practices based on some conclusion that Congress did not intend to preempt the area of franchise regulation. The majority, however, fails to acknowledge that Congress has indeed preempted the field of arbitration as applied to *any* contract in interstate commerce to the extent that title 9 of the United States Code applies. No one has urged before us that there is any basis other than the state regulatory statute upon which to deny application of the Federal Arbitration Act to the contract at issue.

In addition to encouraging the enforcement of arbitration agreements, the Arbitration Act also restricts the benefits of the usually disfavored practice of forum shopping. As the majority recognizes, the likely explanation for the federal district court's remand of the action here was that complete diversity did not exist because of the presence of California defendants. Had those defendants not been named, which was, of course, well within a franchisee's power to choose, the answer would have been

easy. The action could have been readily removed to the federal courts on the basis of diversity and the Arbitration Act unquestionably would have applied. It will thus be seen that the majority implicitly makes the existence or nonexistence of federal jurisdiction the determinative factor in the enforcement of the arbitration clause rather than the existence of a "transaction involving commerce . . . ." In so concluding, the majority ignores the critical distinction which exists in the Arbitration Act between the conferral of federal jurisdiction and the creation of federal substantive law applicable in state courts. This promotes forum shopping.

In a similar context, the court in *In re Mercury Const. Corp.*, supra, specifically observed that, "The addition of the Architect as a party defendant might prevent removal of the state action . . . but it certainly could not frustrate Mercury's plain, indisputable right to an arbitration of *its* dispute with the Hospital." (636 F.2d at p. 942.) The Arbitration Act, construed as national substantive law binding on both federal and state courts, advances consistency.

Finally, I find it significant that sister courts which have specifically considered state statutes analogous to the one before us have found that the Arbitration Act prevails over various state attempts to limit its reach. Thus, in *Allison v. Medicab* (1979) 92 Wash.2d 199, 597 P.2d 380, the Washington Supreme Court reviewed a claim that an arbitration clause in a franchise agreement was invalid under the state's franchise act which gave to the state courts jurisdiction for causes of action based on violations of the state act. Finding that interstate commerce was involved, the *Allison* court rejected the argument that *Wilko v. Swan*, supra, applied to a conflict between a state franchising act and the Federal Arbitration Act. The *Allison* court instead adopted the weight of authority rule applying the federal act in the face of a contrary state law (*id.*, 597 P.2d at p. 382), concluding that "the *supremacy clause of the federal constitu-*

tion must prevail and thus the Federal Arbitration Act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the Franchise Investment Protection Act." (597 P.2d at pp. 382-383, italics added.)

In similar fashion, in *Network Cinema Corporation v. Glassburn* (S.D.N.Y. 1973) 357 F. Supp. 169, the federal district court granted an order staying proceedings in a Kansas state court pending arbitration of a dispute between franchisor and franchisee. The Kansas court had held that the arbitration clause signed by the parties was not enforceable under state law. The federal court nonetheless found that it was empowered to stay state proceedings "when the dispute in question has been found by the court to be subject to the arbitration provisions of 9 U.S.C. § 2." (*Id.*, at p. 172, see also *Main v. Merrill Lynch, Pierce, Fenner & Smith, Inc.* (1977) 67 Cal.App. 3d 19, 23-25, 136 Cal.Rptr. 378, and cases cited therein ["'The Federal Arbitration Act, declaring arbitration agreement affecting [interstate] commerce or maritime affairs to be valid, enforceable, and irrevocable, is a declaration of national law equally applicable in state or federal courts'"]; *Fite & Warmath Const. Co., Inc. v. MYS Corp.* (Ky. 1977) 559 S.W.2d 729, 734-735.)

Finally, in *Barron v. Tastee-Freez Intern., Inc.* (E.D. Wis. 1980) 482 F. Supp. 1213, the federal district court considered the enforcement of an arbitration clause in the face of a state statute analogous to section 31512, which it characterized as similar to 15 United States Code section 77n. (482 F. Supp. at pp. 1215-1216). The court felt compelled by the Federal Arbitration Act "to render void any effort made by a state to protect the remedies of the franchise investors" contrary to the federal act in cases in which the transactions related to interstate commerce. (*Id.*, at p. 1217; see also *Guinness-Harp Corp. v. Jos. Schlitz Brewing* (2d Cir. 1980) 613 F.2d 468, 472.) "The policy embodied in Title 9 U.S.C.

. . . does not depend for its enforceability on the residence of the parties to a contract but rather on the nature of the contract." (*Barron v. Tastee-Freez Intern., Inc.*, supra, 482 F. Supp. at p. 1217.)

The majority attempts to remove a state regulatory statute from the purview of the Federal Arbitration Act in cases involving interstate commerce. In my opinion, its chances of surviving federal review are very dubious. I believe section 31512 is void insofar as it attempts to restrict application of the federal act. Contrary to the majority's assertion, the issue is not the preemption of the field of franchise investment regulation, but rather the clear language of the federal act and the subsequent state and federal court interpretations which consistently demonstrate that the Federal Arbitration Act applies to all claims arising out of transactions in interstate commerce. "Because the United States Arbitration Act is a national substantive law that supplants state arbitration laws, *a state court is bound to apply the act* if the statutory requisites are present; . . ." (*Merrill Lynch, Pierce, Fenner, etc. v. Haydu* (5th Cir. 1981) 637 F.2d 391, 395, italics added.) As the majority first acknowledges and then ignores, "The Franchise Agreements . . . involve interstate commerce and fall within the ambit of the Federal Arbitration Act." (*Ante*, at p. 364 of 183 Cal.Rptr., at p. 1196 of 645 P.2d.) The conclusion that the federal act must prevail is logical, consistent and supported by case law, statutory language, and congressional history. California remains one of the United States, and national substantive law must be applied by us in appropriate cases.

B. CLASS ACTION ARBITRATION

The majority also concludes that class action arbitration may be an appropriate procedure and has remanded the case for determination by the trial court. In the absence of either statutory or contractual authority, I disagree with its holding.

Arbitration is a matter of agreement. It is consensual, being an integral part of the contract. In such situations we have said that the parties "may freely delineate the area of its application." (*O'Malley v. Wilshire Oil Co.* (1963) 59 Cal.2d 482, 490, 30 Cal.Rptr. 452, 381 P.2d 188; see *Reid Burton Const. v. Carpenters Dist. Council, etc.* (10th Cir. 1980) 614 F.2d 698, 702, cert. den. 449 U.S. 824, 101 S.Ct. 85, 66 L.Ed.2d 27.) As a general principle, in considering contract enforcement, "there is perhaps no higher public policy than to uphold and give effect to contracts validly entered into and legally permissible in subject matter." (*Vernon v. Drexel Burnham & Co.* (1975) 52 Cal.App.3d 706, 716, 125 Cal.Rptr. 147.) In the present case, the contracts of the parties do not provide for class arbitration, nor have the parties subsequently agreed thereto. No statute authorizes a court to order arbitration on a class-wide basis. Nonetheless, the majority concludes that such a procedure is possible in order to prevent repetitive arbitration and to avoid "effectively foreclosing individual claims" in instances where the arbitration contract "may be used to insulate the drafter of an adhesion contract from any form of class proceeding." (*Ante*, at p. 375 of 183 Cal. Rptr., at 1207 of 645 P.2d.)

A recent New York case examined the propriety of the class action device used in arbitration. *Harris v. Shearson Hayden Stone, Inc.* (1981) 82 A.D.2d 87, 441 N.Y.S.2d 70, weighed the policies favoring class actions and arbitration and concluded that the filing of a class action alleging a broker's breach of fiduciary duty would not permit avoidance of an agreement to arbitrate. The agreement was contained in a "customer's agreement" which the brokerage firm required all customers to sign. Citing the consistent holdings of our Courts of Appeal in *Vernon v. Drexel Burnham & Co.*, supra, 52 Cal.App.3d 706, 716, 125 Cal.Rptr. 147, and *Frame v. Merrill Lynch*,

Pierce, Fenner & Smith (1971) 20 Cal.App.3d 668, 672, 97 Cal.Rptr. 811, the New York court held that "maintenance of a class action here by assertion of a claim for which a forum is provided elsewhere, would defeat the aim of arbitration, and undercut an avowed purpose of the class action itself—the 'conservation of judicial effort.'" (441 N.Y.S.2d at p. 76.)

In dissent, Justice Bloom urged that the conflict should be resolved in favor of the class action. Even he, however, expressly rejected the idea of a "class arbitration" saying, "Nor is it an anwer to assert that the dispute between plaintiffs and Shearson may be proceeded with as a 'class arbitration.' Arbitration does not lend itself to the many subsidiary proceedings incident to an ongoing class action, e.g. determination of whether class action status should be granted, definition of the class, determination of the nature and kind of notice and by whom it should be sent, provision for opting out, etc. In sum, if the matter is to proceed in arbitration it must proceed as an individual claim." (*Id.*, at p. 79; cf. *Coleman v. National Movie-Dine, Inc.* (E.D.Pa. 1978) 449 F. Supp. 945, 948 ["Arbitration should not be foreclosed simply by adding persons to a civil action who are not parties to the arbitration agreement because such an inclusion would thwart the federal policy in favor of arbitrations. (Citations.)"].) Thus in weighing the policies behind class actions and arbitration, other courts have found that class actions will not prevail where there is an individual arbitration agreement.

In addition to the concerns mentioned by Justice Bloom, other factors belie franchisees' assertion that class certification would be only a "preliminary" issue. For example, a court, in determining whether class proceedings are appropriate, must be satisfied that there is a "community of interest"; i.e., that common issues predominate over individual issues. (See Code Civ. Proc., § 382; *City of San Jose v. Superior Court* (1974) 12

Cal.3d 447, 459-460, 115 Cal.Rptr. 797, 525 P.2d 701; Fed. Rules Civ. Proc., rule 23, 28 U.S.C.) In determining whether a "community of interest" exists, a court must carefully evaluate the nature of the proof that will be presented by the parties (*City of San Jose*, supra, at p. 460, 115 Cal.Rptr. 797, 525 P.2d 701; *Abercrombie v. Lum's Inc.* (S.D.Fla. 1972) 345 F. Supp. 387, 390), and the parties are likely to devote extensive resources to developing the facts and arguments fully in regard to the usually complex certification issues. (See, e.g., *Chance v. Superior Court* (1962) 58 Cal.2d 275, 282-287, 23 Cal.Rptr. 761, 373 P.2d 489; *Blackie v. Barrack* (9th Cir. 1975) 524 F.2d 891, 900-901.)

Moreover, class action procedures would interfere with the expeditious resolution of the claims. After certification of a class, the court must notify class members of the existence of the suit so that they will have the opportunity to "opt out." (Fed. Rules Civ. Proc., rule 23(c), 28 U.S.C.) Because of the due process safeguards required to keep class members apprised of the course of the litigation, substantial judicial involvement by the court will be required to monitor the progress of the arbitration and potentially will undermine the arbitrator's discretion. In fact, the court's due process responsibilities include the duty to "undertake a stringent and continuing examination of the adequacy of representation by the named class representative at all stages of the litigation." (*Nat. Assn. of Reg. Med. Programs, Inc. v. Mathews* (D.C. Cir. 1976) 551 F.2d 340, 344, cert. den. 431 U.S. 954, 97 S.Ct. 2674, 53 L.Ed.2d 270.)

Yet another consideration arises from the fact that unlike settlements reached through arbitration, which are ordinarily not subject to court review on either procedural issues or the merits (see *Barrett v. Manuf. Ry. Co.* (8th Cir. 1972) 453 F.2d 1305, 1307), a class action settlement normally does not become final without court approval. (*La Sala Am. S. & L. Assn.* (1971) 5 Cal.3d

864, 872, 97 Cal.Rptr. 849, 489 P.2d 1113; Fed. Rules Civ. Proc., rule 23(e), 28 U.S.C.; *In re General Motors Corp. Engine Interchange Litig.* (7th Cir. 1979) 594 F.2d 1106, 1124, cert. den. 444 U.S. 870, 100 S.Ct. 146, 62 L.Ed.2d 95.) The court must review the entire proceedings to determine if the settlement was fair, reasonable, and adequate in light of the strength of each party's case (*Marshall v. Holiday Magic, Inc.* (9th Cir. 1977) 550 F.2d 1173, 1178-1179), and take evidence on any substantial objection to the proposed settlement brought by any class member. (*Mandujano v. Basic Vegetable Products, Inc.* (9th Cir. 1976) 541 F.2d 832, 835-836.)

Finally, the normally "informal" nature of arbitration requires no transcripts. Arbitrators generally need not explain the basis for their decision. (*Bernhardt v. Polygraphic Co. of America* (1956) 350 U.S. 198, 203-204, and fn. 4, 76 S.Ct. 273, 276, and fn. 4, 100 L.Ed. 199.) The absence of a record further complicates the use of class proceedings, because without a record a court may have difficulty in applying an arbitrator's decision to all class members, since it could not determine whether the arbitrator's judgment was applicable to each member of the class, or based on equities applicable only to the individual claimant. Similarly, objection to settlements would be difficult to assess.

In addition, arbitrators, of course, are not necessarily either lawyers or judges. Requiring the administration of complex class procedures during arbitration may either make lay experts unavailable as arbitrators as a practical matter, or result in intrusive judicial participation and supervision.

In summary, class procedures would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal. " 'An arbitration proceeding is, except in specified particulars, outside the court realm and jurisdiction—deliberately so

taken out of the court by choice and commitment of the parties. Arbitration is subject to its own rules and practices at variance with court proceedings. It is supposed to be a complete proceeding, without resort to court facilities . . . . It would be generally incompatible with the nature and scope of arbitration to allow a shift to the court forum . . . .' (*Application of Katz*, 3 App. Div.2d 238, 160 N.Y.S.2d 159, . . .)" (*East San Bernardino County Water Dist. v. City of San Bernardino* (1973) 33 Cal.App.3d 942, 950, 109 Cal.Rptr. 510.)

In my view, because of the complications resulting from continued judicial monitoring, the imposition of class action procedures on the arbitration process would be self-defeating.

Nonetheless, by analogy to consolidated arbitration proceedings, the majority insists that *class arbitration* is an available remedy. However, several factors make this analogy less than compelling. In *Atlas Plastering, Inc. v. Superior Court* (1977) 72 Cal.App.3d 63, 140 Cal.Rptr. 59, Atlas, a general contractor, sought to consolidate arbitration proceedings between itself and several subcontractors, each of whom had entered into identical arbitration agreements with Atlas. The *Atlas* court held that, because the parties had not agreed to consolidated proceedings and because consolidation would deprive the individual subcontractors of their right to choose an arbitrator in the manner set forth in the arbitration agreement, the court lacked the power to order consolidated proceedings. (Code Civ.Proc., § 1281.6.) When *Atlas* was decided, no statute authorized a court to order consolidation of arbitrations.

Following the decision in *Atlas*, the Legislature enacted Code of Civil Procedure section 1281.3 which specifically authorizes consolidated arbitration at the court's discretion under certain circumstances. This section was relied upon in *Conejo Valley Unified School Dist. v. Wil-*

liam Blurock & Partners, Inc. (1980) 111 Cal.App.3d 983, 169 Cal.Rptr. 102, in which a party to an arbitration agreement was compelled to arbitrate his claim in consolidated proceedings despite the fact that the agreements contained conflicting provisions for choosing an arbitrator. The *Conejo* court held that section 1281.3 did not create substantive rights, but was a procedural statute and that therefore no constitutional bar to its retroactive application existed.

Unlike the *Conejo* situation, there is no state statute which permits a court to order arbitration proceedings on a class-wide basis when the contractual arrangement of the parties does not authorize it. The Legislature examined the specific problems of related arbitration proceedings when it permitted the consolidation of arbitration. After scrutinizing these problems the Legislature declined to provide for class arbitration.

Nor, as the majority concedes, is there any federal authority for class arbitration. Although federal courts have ordered consolidated arbitration under the authority of rule 42(a) of the Federal Rules of Civil Procedure, the courts have attempted to assure each party the right to select an arbitrator and to express their individual views. (See, e.g., *Compania Espanola de Pet., S.A. v. Nereus Ship.* (2d Cir. 1975) 527 F.2d 966, 974-975, cert. den. (1976) 426 U.S. 936, 96 S.Ct. 2650, 49 L.Ed. 2d 387; *Marine Trading Ltd. v. Ore Intern. Corp.* (S.D.N.Y. 1977) 432 F.Supp. 683, 685; *Robinson v. Warner* (D.R.I.1974) 370 F.Supp. 828, 829.) In fact, the issue of the application of *consolidation* to arbitration proceedings is not a settled matter in the federal courts. (See *Gavlik Construction Co. v. H. F. Campbell Co.* (W.D.Pa.1975) 389 F.Supp. 551, 556, revd. on other grounds (3d Cir.) 526 F.2d 777; see also *Robinson v. Warner*, supra, at p. 830.)

In the absence of a statute authorizing class arbitration or agreement of the parties, it is inappropriate in

my view for us, judicially, to superimpose such a procedure on the arbitration process over objections of a party to the contract. (Compare, *Stevenson v. Com., Dept. of Revenue* (1980) 489 Pa. 1, 413 A.2d 667 [the Pennsylvania Board of Arbitration of Claims Act specifically incorporates procedures embodied in rules of Pennsylvania civil procedure and class action is therefore available to parties appearing before board].)

The majority is compelled to acknowledge that class-wide arbitration "would entail a greater degree of judicial involvement than is normally associated with arbitration . . . ." (*Ante*, at p. 377 of 183 Cal.Rptr., at p. 1209 of 645 P.2d.) Nonetheless, it argues that if the alternative would be to require hundreds of individual arbitration proceedings, then such a procedure may be appropriate. I believe, however, that the majority fails to accord proper deference to the recognized principle that arbitration is a *favored* means of dispute resolution because it permits a *non-judicial*, *informal*, and *speedy* alternative to litigation. (See, e.g., *Taylor v. Crane* (1979) 24 Cal.3d 442, 452, 155 Cal.Rptr. 695, 595 P.2d 129; *Doers v. Golden Gate Bridge etc. Dist.* (1979) 23 Cal.3d 180, 189, 151 Cal.Rptr. 837, 588 P.2d 1261; Aerojet-General Corp. v. American Arbitration Assn. (9th Cir. 1973) 478 F.2d 248, 251.) The injection of class action procedure into the arbitration process *in the absence of either statutory authority or contractual agreement* conflicts with these settled principles as well as with the specific contract terms to which the parties agreed. "It is axiomatic that commercial arbitration is to be based on a voluntary agreement of the parties[;] only then can the concept of arbitration be well understood. In other words, nobody should be bound to resort to arbitration unless he has previously agreed to that method of dispute settlement." (Domke on Commercial Arbitration (1968) § 1.02, p.5.)

The franchisees here do not contend that they would be unable to proceed individually in separate or consolidated arbitration proceedings. We are not confronted with a situation in which a plaintiff contends that it would be economically unfeasible to mount a challenge in the absence of a class proceeding. In fact, not all of the actions before us have been brought as class actions. It is very clear that the individual franchisees have been fully able to proceed.

In a case where class proceedings provide the only economical method of presenting a claim, an alternative exists which would protect both the contractual integrity of proper arbitration agreements and the interests of individual claimants. One solution which has been suggested, and which the majority rejects, "would be to hold that arbitration agreements contained in contracts of adhesion may not operate to stay properly maintainable class actions." (*Ante*, at p. 375 of 183 Cal.Rptr., at p. 1207 of 645 P.2d.) I agree that as a general rule such a holding would be contrary to the basic arbitration agreement of the parties and to the policy favoring arbitration. There is, however, another alternative. Under settled principles of law, arbitration clauses in adhesion contracts may be declared invalid where they are "beyond the reasonable expectations of an ordinary person . . . ." (*Wheeler v. St. Joseph Hospital* (1976) 63 Cal.App.3d 345, 357, 133 Cal.Rptr. 775) or bear oppressively on the weaker party. (*Madden v. Kaiser Foundation Hospitals* (1976) 17 Cal.3d 699, 710, 131 Cal.Rptr. 882, 552 P.2d 1178; *Graham v. Scissor-Tail, Inc.* (1981) 28 Cal.3d 807, 820, 171 Cal.Rptr. 604, 623 P.2d 165.) Thus, where an arbitration clause in an adhesion contract would allow the stronger party to evade responsibility for its acts, such a clause may, under those facts, be found oppressive and the clause invalidated. In instances where an arbitration clause would effectively deny relief to the weaker party in an adhesion contract,

relief under settled principles of law would potentially be available. As the majority concludes, there is no such evasion of liability here, and consequently, there is no need for an extraordinary remedy such as the one proposed by the majority.

In summary, the majority, in the absence of any contractual, statutory, or judicial authority or any demonstrated need, has seen fit to invent a procedure which is fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration. Potentially, the majority's holding will effectively render arbitration clauses in all adhesion contracts subject to class treatment, thus engrafting on an informal, speedy method of dispute resolution which often utilizes nonlegal arbitrators a complex legal procedure which will require close court supervision and frequent intervention antithetical to the essential informal and nonjudicial nature of the arbitration process.

CONCLUSION

From the foregoing, I conclude that the trial court erred in holding that the Franchise Investment Law claims were not arbitrable in the face of the clear national substantive law to the contrary. I would reverse the trial court judgment to the extent that it denies arbitration of these claims. In addition, I conclude that in the absence of any statutory or contractual agreement to the contrary, the strong policy reasons favoring arbitration as a speedy, informal and nonjudicial method of dispute resolution militate against the remand of this case to the trial court to permit it to determine whether class arbitration may be an appropriate procedure. I would affirm the trial court's order referring the individual cases to arbitration, recognizing that *consolidation* of the individual arbitrations might be proper.

MOSK, J., concurs.

SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1983

No. 82-500

SOUTHLAND CORP. *et al.*

v.

KEATING *et al.*

Appeal from the Supreme Court of California

Argued October 4, 1983—Decided January 23, 1984

Mark J. Spooner argued the case for appellants. With him on the briefs were *Peter K. Bleakley* and *Martin H. Krese.*

John F. Wells argued the cause for appellees. With him on the brief were *Lise A. Pearlman* and *Fonda Karelitz.**

CHIEF JUSTICE BURGER delivered the opinion of the Court.

This case presents the questions (a) whether the California Franchise Investment Law, which invalidates certain arbitration agreements covered by the Federal Arbitration Act, violates the Supremacy Clause and (b)

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* A brief of *amici curiae* was filed by *Simon H. Trevas* for the Securities Division of the State of Washington et al.

whether arbitration under the federal Act is impaired when a class-action structure is imposed on the process by the state courts.

I

Appellant Southland Corp. is the owner and franchisor of 7-Eleven convenience stores. Southland's standard franchise agreement provides each franchisee with a license to use certain registered trademarks, a lease or sublease of a convenience store owned or leased by Southland, inventory financing, and assistance in advertising and merchandising. The franchisees operate the stores, supply bookkeeping data, and pay Southland a fixed percentage of gross profits. The franchise agreement also contains the following provision requiring arbitration:

> "Any controversy or claim arising out of or relating to this Agreement or the breach hereof shall be settled by arbitration in accordance with the Rules of the American Arbitration Association . . . and judgment upon any award rendered by the arbitrator may be entered in any court having jurisdiction thereof."

Appellees are 7-Eleven franchisees. Between September 1975 and January 1977, several appellees filed individual actions against Southland in California Superior Court alleging, among other things, fraud, oral misrepresentation, breach of contract, breach of fiduciary duty, and violation of the disclosure requirements of the California Franchise Investment Law, Cal. Corp. Code Ann. § 31000 *et seq.* (West 1977). Southland's answer, in all but one of the individual actions, included the affirmative defense of failure to arbitrate.

In May 1977, appellee Keating filed a class action against Southland on behalf of a class that assertedly includes approximately 800 California franchisees. Keating's principal claims were substantially the same as

those asserted by the other franchisees. After the various actions were consolidated, Southland petitioned to compel arbitration of the claims in all cases, and appellees moved for class certification.

The Superior Court granted Southland's motion to compel arbitration of all claims except those claims based on the Franchise Investment Law. The court did not pass on appellees' request for class certification. Southland appealed from the order insofar as it excluded from arbitration the claims based on the California statute. Appellees filed a petition for a writ of mandamus or prohibition in the California Court of Appeal arguing that the arbitration should proceed as a class action.

The California Court of Appeal reversed the trial court's refusal to compel arbitration of appellees' claims under the Franchise Investment Law. *Keating* v. *Superior Court, Alameda County*, 167 Cal. Rptr. 481 (1980). That court interpreted the arbitration clause to require arbitration of all claims asserted under the Franchise Investment Law, and construed the Franchise Investment Law not to invalidate such agreements to arbitrate.[1] Alternatively, the court concluded that if the Franchise Investment Law rendered arbitration agreements involving commerce unenforceable, it would conflict with § 2 of the Federal Arbitration Act, 9 U.S.C. § 2, and therefore be invalid under the Supremacy Clause. 167 Cal. Rptr., at 493-494. The Court of Appeal also determined that there was no "insurmountable obstacle" to conducting an arbitration on a classwide basis, and issued a writ of mandate directing the trial court to conduct class-certification proceedings. *Id.*, at 492.

The California Supreme Court, by a vote of 4-2, reversed the ruling that claims asserted under the Franchise

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[1] California Corp. Code Ann. § 31512 (West 1977) provides: "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void."

Investment Law are arbitrable. *Keating* v. *Superior Court of Alameda County*, 31 Cal. 3d 584, 645 P. 2d 1192 (1982). The California Supreme Court interpreted the Franchise Investment Law to require judicial consideration of claims brought under that statute and concluded that the California statute did not contravene the federal Act. *Id.*, at 604, 645 P. 2d, 1203-1204. The court also remanded the case to the trial court for consideration of appellees' request for classwide arbitration.

We postponed consideration of the question of jurisdiction pending argument on the merits. 459 U. S. 1101 (1983). We reverse in part and dismiss in part.

II

A

Jurisdiction of this Court is asserted under 28 U. S. C. § 1257(2), which provides for an appeal from a final judgment of the highest court of a state when the validity of a challenged state statute is sustained as not in conflict with federal law. Here Southland challenged the California Franchise Investment Law as it was applied to invalidate a contract for arbitration made pursuant to the Federal Arbitration Act. Appellees argue that the action of the California Supreme Court with respect to this claim is not a "final judgment or decree" within the meaning of § 1257(2).

Under *Cox Broadcasting Corp.* v. *Cohn*, 420 U. S. 469, 482-483 (1975), judgments of state courts that finally decide a federal issue are immediately appealable when "the party seeking review here might prevail [in the state court] on the merits on nonfederal grounds, thus rendering unnecessary review of the federal issue by this Court, and where reversal of the state court on the federal issue would be preclusive of any further litigation on the relevant cause of action . . . ." In these circumstances, we have resolved the federal issue "if a refusal immedi-

ately to review the state-court decision might seriously erode federal policy." *Id.*, at 483.

The judgment of the California Supreme Court with respect to this claim is reviewable under *Cox Broadcasting*, supra. Without immediate review of the California holding by this Court there may be no opportunity to pass on the federal issue and as a result "there would remain in effect the unreviewed decision of the State Supreme Court" holding that the California statute does not conflict with the Federal Arbitration Act. *Id.*, at 485. On the other hand, reversal of a state-court judgment in this setting will terminate litigation of the merits of this dispute.

Finally, the failure to accord immediate review of the decision of the California Supreme Court might "seriously erode federal policy." Plainly the effect of the judgment of the California court is to nullify a valid contract made by private parties under which they agreed to submit all contract disputes to final, binding arbitration. The federal Act permits "parties to an arbitrable dispute [to move] out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U. S. 1, 22 (1983).

Contracts to arbitrate are not to be avoided by allowing one party to ignore the contract and resort to the courts. Such a course could lead to prolonged litigation, one of the very risks the parties, by contracting for arbitration, sought to eliminate. In *The Bremen* v. *Zapata Off-Shore Co.*, 407 U. S. 1, 12 (1972), we noted that the contract fixing a particular forum for resolution of all disputes

> "was made in an arm's-length negotiation by experienced and sophisticated businessmen, and absent some compelling and countervailing reason it should be honored by the parties and enforced by the courts."

The *Zapata* Court also noted that

> "the forum clause was a vital part of the agreement, and it would be unrealistic to think that the parties

> did not conduct their negotiations, including fixing the monetary terms, with the consequences of the forum clause figuring prominently in their calculations." *Id.*, at 14 (footnote omitted).

For us to delay review of a state judicial decision denying enforcement of the contract to arbitrate until the state-court litigation has run its course would defeat the core purpose of a contract to arbitrate. We hold that the Court has jurisdiction to decide whether the Federal Arbitration Act preempts § 31512 of the California Franchise Investment Law.

B

That part of the appeal relating to the propriety of superimposing class-action procedures on a contract arbitration raises other questions. Southland did not contend in the California courts that, and the state courts did not decide whether, state law imposing class-action procedures was pre-empted by federal law. When the California Court of Appeal directed Southland to address the question whether state or federal law controlled the class-action issue, Southland responded that *state law* did not permit arbitrations to proceed as class actions, that the Federal Rules of Civil Procedure were inapplicable, and that requiring arbitrations to proceed as class actions "could well violate the [federal] constitutional guaranty of procedural due process." [2] Southland did not claim in the Court of Appeal that if state law required class-action procedures, it would conflict with the federal Act and thus violate the Supremacy Clause.

In the California Supreme Court, Southland argued that California law applied but that neither the contract to arbitrate nor state law authorized class-action procedures to govern arbitrations. Southland also contended

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[2] Supplemental Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition in Civ. No. 45162 (Ct. App. Cal., 1st App. Dist.), pp. 19-25.

that the Federal Rules were inapplicable in state proceedings. Southland pointed out that although California law provided a basis for class-action procedures, the Judicial Council of California acknowledged "the incompatibility of class actions and arbitration." Petition for Hearing 23. It does not appear that Southland opposed class procedures on *federal* grounds in the California Supreme Court.[3] Nor does the record show that the California Supreme Court passed upon the question whether superimposing class-action procedures on a contract arbitration was contrary to the federal Act.[4]

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[3] The question Southland presented to the State Supreme Court was "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act . . . to proceed as a class action even though the terms of the parties' arbitration agreement do not provide for such a procedure." Petition for Hearing in Civ. No. 45162 (Cal. 1980). Southland argued that (1) the decision of the Court of Appeal "is in conflict with the decisions of other Courts of Appeal in this State," *id.*, at 3; (2) class actions would delay and complicate arbitration, increase its cost, and require judicial supervision, "considerations [which] strongly militate against the creation of class action arbitration procedures," *id.*, at 22; and (3) there was no basis in law for class actions. According to appellants, the Federal Rules of Civil Procedure did not apply in California courts. *Id.*, at 23. Southland thus relied, not on federal law, but on California law in opposing class-action procedures.

[4] The California Supreme Court cited "[a]nalogous authority" supporting consolidation of arbitration proceedings by federal courts. 31 Cal. 3d, at 611-612, 645 P.2d, at 1208. *E.g., Compania Espanola de Petroleos, S. A. v. Nereus Shipping, S. A.*, 527 F.2d 966, 975 (CA2 1975), cert. denied, 426 U.S. 936 (1976); *In re Czarnikow-Rionda Co.*, 512 F. Supp. 1308, 1309 (S.D.N.Y. 1981). This, along with support by other state courts and the California Legislature for consolidation of arbitration proceedings, permitted the court to conclude that class-action proceedings were authorized: "It is unlikely that the state Legislature in adopting the amendment to the Arbitration Act authorizing consolidation of arbitration proceedings, intended to preclude a court from ordering classwide arbitration in an appropriate case. We conclude that a court is not without authority

Since it does not affirmatively appear that the validity of the state statute was "drawn in question" *on federal grounds* by Southland, this Court is without jurisdiction to resolve this question as a matter of federal law under 28 U. S. C. § 1257(2). See *Bailey* v. *Anderson*, 326 U.S. 203, 207 (1945).

III

As previously noted, the California Franchise Investment Law provides:

> "Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void." Cal. Corp. Code Ann. § 31512 (West 1977).

The California Supreme Court interpreted this statute to require judicial consideration of claims brought under the state statute and accordingly refused to enforce the parties' contract to arbitrate such claims. So interpreted the California Franchise Investment Law directly conflicts with § 2 of the Federal Arbitration Act and violates the Supremacy Clause.

In enacting § 2 of the federal Act, Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration. The Federal Arbitration Act provides:

> "A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing

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to do so." 31 Cal. 3d, at 613, 645 P.2d, at 1209. The California Supreme Court thus ruled that imposing a class-action structure on the arbitration process was permissible as a matter of state law.

> controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2.

Congress has thus mandated the enforcement of arbitration agreements.

We discern only two limitations on the enforceability of arbitration provisions governed by the Federal Arbitration Act: they must be part of a written maritime contract or a contract "evidencing a transaction involving commerce" [5] and such clauses may be revoked upon "grounds as exist at law or in equity for the revocation of any contract." We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law.

The Federal Arbitration Act rests on the authority of Congress to enact substantive rules under the Commerce Clause. In *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U. S. 395 (1967), the Court examined the legislative history of the Act and concluded that the statute "is based upon . . . the incontestable federal foundations of 'control over interstate commerce and over admiralty.'" *Id.*, at 405 (quoting H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924)). The contract in *Prima Paint*, as here, contained an arbitration clause. One party in that case alleged that the other had committed fraud in the inducement of the contract, although not of the arbitration clause in particular, and sought to have the claim of fraud adjudicated in federal court. The Court held that, notwithstanding a contrary state rule, consideration of a claim of fraud in the inducement of a contract "is for the

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[5] We note that in defining "commerce" Congress declared that "nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce." 9 U.S.C. § 1.

arbitrators and not for the courts," 388 U. S., at 400. The Court relied for this holding on Congress' broad power to fashion substantive rules under the Commerce Clause.[6]

At least since 1824 Congress' authority under the Commerce Clause has been held plenary. *Gibbons* v. *Ogden*, 9 Wheat. 1, 196 (1824). In the words of Chief Justice Marshall, the authority of Congress is "the power to regulate; that is, to prescribe the rule by which commerce is to be governed." *Ibid.* The statements of the Court in *Prima Paint* that the Arbitration Act was an exercise of the Commerce Clause power clearly implied that the substantive rules of the Act were to apply in state as well as federal courts. As Justice Black observed in his dissent, when Congress exercises its authority to enact substantive federal law under the Commerce Clause, it normally creates rules that are enforceable in state as well as federal courts. *Prima Paint, supra,* at 420.

In *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U. S., at 1, 25, and n. 32, we reaffirmed our view that the Arbitration Act "creates a body of federal substantive law" and expressly stated what was implicit in *Prima Paint, i. e.*, the substantive law the Act created was applicable in state and federal courts. *Moses H. Cone* began with a petition for an order to compel arbitration. The District Court stayed the action pending resolution of a concurrent state-court suit. In holding that the District Court had abused its discretion, we found no showing of exceptional circumstances justifying the stay and recognized "the presence of federal-law issues" under the federal Act as "a major consideration weighing against surrender [of federal jurisdiction]." 460 U.S. at 26. We thus read the underlying issue of arbitrability to be a question of substantive federal law: "Federal law

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[6] The procedures to be used in an arbitration are not prescribed by the federal Act. We note, however, that *Prima Paint* considered the question of what issues are for the courts and what issues are for the arbitrator.

in the terms of the Arbitration Act governs that issue in either state or federal court." *Id.*, at 24.

Although the legislative history is not without ambiguities, there are strong indications that Congress had in mind something more than making arbitration agreements enforceable only in the federal courts. The House Report plainly suggests the more comprehensive objectives:

> "The purpose of this bill is to make valid enforcible [*sic*] agreements for arbitration contained *in contracts involving interstate commerce* or within the jurisdiction or [*sic*] admiralty, *or* which may be the subject of litigation in the Federal courts." H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924) (emphasis added).

This broader purpose can also be inferred from the reality that Congress would be less likely to address a problem whose impact was confined to federal courts than a problem of large significance in the field of commerce. The Arbitration Act sought to "overcome the rule of equity, that equity will not specifically enforce an[y] arbitration agreement." Hearing on S. 4213 and S. 4214 before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 6 (1923) (Senate Hearing) (remarks of Sen. Walsh). The House Report accompanying the bill stated:

> "The need for the law arises from . . . the jealousy of the English courts for their own jurisdiction. . . . This jealously survived for so lon[g] a period that the principle became firmly embedded in the English common law and was adopted with it by the American courts. The courts have felt that the precedent was too strongly fixed to be overturned without legislative enactment . . . ." H. R. Rep. No. 96, *supra*, at 1-2.

Surely this makes clear that the House Report contemplated a broad reach of the Act, unencumbered by state-

law constraints. As was stated in *Metro Industrial Painting Corp.* v. *Terminal Construction Co.*, 287 F. 2d 382, 387 (CA2 1961) (Lumbard, C. J., concurring), "the purpose of the act was to assure those who desired arbitration and whose contracts related to interstate commerce that their expectations would not be undermined by federal judges, or . . . by state courts or legislatures." Congress also showed its awareness of the widespread unwillingness of state courts to enforce arbitration agreements, *e. g.*, Senate Hearing, at 8, and that such courts were bound by state laws inadequately providing for

> "technical arbitration by which, if you agree to arbitrate under the method provided by the statute, you have an arbitration by statute[;] but [the statutes] ha[d] nothing to do with validating the contract to arbitrate." *Ibid.*

The problems Congress faced were therefore twofold: the old common-law hostility toward arbitration, and the failure of state arbitration statutes to mandate enforcement of arbitration agreements. To confine the scope of the Act to arbitrations sought to be enforced in federal courts would frustrate what we believe Congress intended to be a broad enactment appropriate in scope to meet the large problems Congress was addressing.

JUSTICE O'CONNOR argues that Congress viewed the Arbitration Act "as a procedural statute, applicable only in federal courts." *Post*, at 25. If it is correct that Congress sought only to create a procedural remedy in the federal courts, there can be no explanation for the express limitation in the Arbitration Act to contracts "involving commerce." 9 U.S.C. § 2. For example, when Congress has authorized this Court to prescribe the rules of procedure in the federal courts of appeals, district courts, and bankruptcy courts, it has not limited the power of the Court to prescribe rules applicable only to causes of action involving commerce. See, *e.g.*, 28 U.S.C.

§§ 2072, 2075, 2076 (1976 ed. and Supp. V). We would expect that if Congress, in enacting the Arbitration Act, was creating what it thought to be a procedural rule applicable only in federal courts, it would not so limit the Act to transactions involving commerce. On the other hand, Congress would need to call on the Commerce Clause if it intended the Act to apply in state courts. Yet at the same time, its reach would be limited to transactions involving interstate commerce. We therefore view the "involving commerce" requirement in § 2, not as an inexplicable limitation on the power of the federal courts, but as a necessary qualification on a statute intended to apply in state and federal courts.

Under the interpretation of the Arbitration Act urged by JUSTICE O'CONNOR, claims brought under the California Franchise Investment Law are not arbitrable when they are raised in state court. Yet it is clear beyond question that if this suit had been brought as a diversity action in a federal district court, the arbitration clause would have been enforceable.[7] *Prima Paint*, *supra*. The interpretation given to the Arbitration Act by the California Supreme Court would therefore encourage and reward forum shopping. We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted. And since the overwhelming proportion of all civil litigation in this country is in

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[7] Appellees contend that the arbitration clause, which provides for the arbitration of "any controversy or claim arising out of or relating to this Agreement or the breach hereof," does not cover their claims under the California Franchise Investment Law. We find the language quoted above broad enough to cover such claims. Cf. *Prima Paint*, 388 U.S., at 403-404, 406 (finding nearly identical language to cover a claim that a contract was induced by fraud).

the state courts,[8] we cannot believe Congress intended to limit the Arbitration Act to disputes subject only to *federal*-court jurisdiction.[9] Such an interpretation would frustrate congressional intent to place "[a]n arbitration agreement . . . upon the same footing as other contracts, where it belongs." H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924).

In creating a substantive rule applicable in state as well as federal courts,[10] Congress intended to foreclose

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[8] It is estimated that 2% of all civil litigation in this country is in the federal courts. Annual Report of the Director of the Administrative Office of the U.S. Courts 3 (1982) (206,000 filings in federal district courts in 12 months ending June 30, 1982, excluding bankruptcy filings); Flango & Elsner, Advance Report, The Latest State Court Caseload Data, 7 State Court J., 18 (Winter 1983) (approximately 13,600,000 civil filings during comparable period, excluding traffic filings).

[9] While the Federal Arbitration Act creates federal substantive law requiring the parties to honor arbitration agreements, it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 or otherwise. *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U.S. 1, 25, n.32 (1983). This seems implicit in the provisions in § 3 for a stay by a "court in which such suit is pending" and in § 4 that enforcement may be ordered by "any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties." *Ibid.*; *Prima Paint*, *supra*, at 420, and n.24 (Black, J., dissenting); *Krauss Bros. Lumber Co.* v. *Louis Bossert & Sons, Inc.*, 62 F.2d 1004, 1006 (CA2 1933) (L. Hand, J.).

[10] The contention is made that the Court's interpretation of § 2 of the Act renders §§ 3 and 4 "largely superfluous." *Post*, at 31, n. 20. This misreads our holding and the Act. In holding that the Arbitration Act preempts a state law that withdraws the power to enforce arbitration agreements, we do not hold that §§ 3 and 4 of the Arbitration Act apply to proceedings in state courts. Section 4, for example, provides that the Federal Rules of Civil Procedure apply in proceedings to compel arbitration. The Federal Rules do not apply in such state-court proceedings.

state legislative attempts to undercut the enforceability of arbitration agreements.[11] We hold that § 31512 of the California Franchise Investment Law violates the Supremacy Clause.

IV

The judgment of the California Supreme Court denying enforcement of the arbitration agreement is reversed; as to the question whether the Federal Arbitration Act precludes a class-action arbitration and any other issues not raised in the California courts, no decision by this Court would be appropriate at this time. As to the latter issues, the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

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[11] The California Supreme Court justified its holding by reference to our conclusion in *Wilko* v. *Swan*, 346 U.S. 427 (1953), that arbitration agreements are nonbinding as to claims arising under the federal Securities Act of 1933. 31 Cal. 3d, at 602, 645 P. 2d, at 1202-1203. The analogy is unpersuasive. The question in *Wilko* was not whether a state legislature could create an exception to § 2 of the Arbitration Act, but rather whether Congress, in subsequently enacting the Securities Act, had in fact created such an exception.

JUSTICE STEVENS dissents in part on the ground that § 2 of the Arbitration Act permits a party to nullify an agreement to arbitrate on "such grounds as exist at law or inequity for the revocation of any contract." *Post*, at 19. We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement. We conclude, however, that the defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity "for the revocation of *any* contract" but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law. Moreover, under this dissenting view, "a state policy of providing special protection for franchisees . . . can be recognized without impairing the basic purposes of the federal statute." *Post*, at 21. If we accepted this analysis, states could wholly eviscerate congressional intent to place arbitration agreements "upon the same footing as other contracts," H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924), simply by passing statutes such as the Franchise Investment Law. We have

JUSTICE STEVENS, concurring in part and dissenting in part.

The Court holds that an arbitration clause that is enforceable in an action in a federal court is equally enforceable if the action is brought in a state court. I agree with that conclusion. Although JUSTICE O'CONNOR's review of the legislative history of the Federal Arbitration Act demonstrates that the 1925 Congress that enacted the statute viewed the statute as essentially procedural in nature, I am persuaded that the intervening developments in the law compel the conclusion that the Court has reached. I am nevertheless troubled by one aspect of the case that seems to trouble none of my colleagues.

For me it is not "clear beyond question that if this suit had been brought as a diversity action in a federal district court, the arbitration clause would have been enforceable." *Ante*, at 15. The general rule prescribed by § 2 of the Federal Arbitration Act is that arbitration clauses in contracts involving interstate transactions are enforceable as a matter of federal law. That general rule, however, is subject to an exception based on "such grounds as exist at law or in equity for the revocation of any contract." I believe that exception leaves room for the implementation of certain substantive state policies that would be undermined by enforcing certain categories of arbitration clauses.

The exercise of state authority in a field traditionally occupied by state law will not be deemed pre-empted by a federal statute unless that was the clear and manifest purpose of Congress. *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 157 (1978); see generally The Federalist No. 32, p. 200 (Van Doren ed. 1945) (A. Hamilton). More-

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rejected this analysis because it is in conflict with the Arbitration Act and would permit states to override the declared policy requiring enforcement of arbitration agreements.

over, even where a federal statute does displace state authority, it "rarely occupies a legal field completely, totally excluding all participation by the legal systems of the states. . . . Federal legislation, on the whole, has been conceived and drafted on an *ad hoc* basis to accomplish limited objectives. It builds upon legal relationships established by the states, altering or supplanting them only so far as necessary for the special purpose." P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, Hart and Wechsler's The Federal Courts and the Federal System 470-471 (2d ed. 1973).

The limited objective of the Federal Arbitration Act was to abrogate the general common-law rule against specific enforcement of arbitration agreements, S. Rep. No. 536, 68th Cong., 1st Sess., 2-3 (1924), and a state statute which merely codified the general common-law rule—either directly by employing the prior doctrine of revocability or indirectly by declaring all such agreements void—would be pre-empted by the Act. However, beyond this conclusion, which seems compelled by the language of § 2 and case law concerning the Act, it is by no means clear that Congress intended entirely to displace state authority in this field. Indeed, while it is an understatement to say that "the legislative history of the . . . Act . . . reveals little awareness on the part of Congress that state law might be affected," it must surely be true that given the lack of "clear mandate from Congress as to the extent to which state statutes and decisions are to be superseded, we must be cautious in construing the act lest we excessively encroach on the powers which Congressional policy, if not the Constitution, would reserve to the states." *Metro Industrial Painting Corp.* v. *Terminal Construction Co.*, 287 F.2d 382, 386 (CA2 1961) (Lumbard, C.J., concurring).

The textual basis in the Act for avoiding such encroachment is the clause of § 2 which provides that arbitration agreements are subject to revocation on such

grounds as exist at law or in equity for the revocation of any contract. The Act, however, does not define what grounds for revocation may be permissible, and hence it would appear that the judiciary must fashion the limitations as a matter of federal common law. Cf. *Textile Workers* v. *Lincoln Mills*, 353 U.S. 448 (1957). In doing so, we must first recognize that as the " 'saving clause' in § 2 indicates, the purpose of Congress in 1925 was to make arbitration agreements as enforceable as other contracts, but not more so." *Prima Paint Co.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404, n.12 (1967); see also, H.R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924). The existence of a federal statute enunciating a substantive federal policy does not necessarily require the inexorable application of a uniform federal rule of decision notwithstanding the differing conditions which may exist in the several States and regardless of the decisions of the States to exert police powers as they deem best for the welfare of their citizens. Cf. *Wallis* v. *Pan American Petroleum Corp.*, 384 U.S. 63, 69 (1966); see generally *Wilson* v. *Omaha Indian Tribe*, 442 U.S. 653, 671-672 (1979); *United States* v. *Kimbell Foods, Inc.*, 440 U.S. 715 (1979); *Clearfield Trust Co.* v. *United States*, 318 U.S. 363 (1943). Indeed, the lower courts generally look to state law regarding questions of formation of the arbitration agreement under § 2, see, *e.g.*, *Comprehensive Merchandising Catalogs, Inc.* v. *Madison Sales Corp.*, 521 F.2d 1210 (CA7 1975), which is entirely appropriate so long as the state rule does not conflict with the policy of § 2.

A contract which is deemed void is surely revocable at law or in equity, and the California Legislature has declared all conditions purporting to waive compliance with the protections of the Franchise Investment Law, including but not limited to arbitration provisions, void as a matter of public policy. Given the importance to the State of franchise relationships, the relative disparity in

the bargaining positions between the franchisor and the franchisee, and the remedial purposes of the California Act, I believe this declaration of state policy is entitled to respect.

Congress itself struck a similar balance in § 14 of the Securities Act of 1933, 15 U. S. C. § 77n, and did not find it necessary to amend the Federal Arbitration Act. Rather, this Court held that the Securities Act provision invalidating arbitration agreements in certain contexts could be reconciled with the general policy favoring enforcement of arbitration agreements. *Wilko* v. *Swan*, 346 U. S. 427 (1953). Repeals by implication are of course not favored, and we did not suggest that Congress had intended to repeal or modify the substantive scope of the Arbitration Act in passing the Securities Act. Instead, we exercised judgment, scrutinizing the policies of the Arbitration Act and their applicability in the special context of the remedial legislation at issue, and found the Arbitration Act inapplicable. We have exercised such judgment in other cases concerning the scope of the Arbitration Act, and have focused not on sterile generalization, but rather on the substance of the transaction at issue, the nature of the relationship between the parties to the agreement, and the purpose of the regulatory scheme. See, *e.g.*, *Scherk* v. *Alberto-Culver Co.*, 417 U. S. 506 (1974), rev'g 484 F. 2d 611 (CA7 1973); see also, *id.*, at 615-620 (Stevens, Circuit Judge, dissenting). Surely the general language of the Arbitration Act that arbitration agreements are valid does not mean that all such agreements are valid irrespective of their purpose or effect. See generally *Paramount Famous Lasky Corp.* v. *United States*, 282 U. S. 30 (1930) (holding arbitration agreement void as a restraint of trade).

We should not refuse to exercise independent judgment concerning the conditions under which an arbitration

agreement, generally enforceable under the Act, can be held invalid as contrary to public policy simply because the source of the substantive law to which the arbitration agreement attaches is a State rather than the Federal Government. I find no evidence that Congress intended such a double standard to apply, and I would not lightly impute such an intent to the 1925 Congress which enacted the Arbitration Act.

A state policy excluding wage claims from arbitration, cf. *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U. S. 117 (1973), or a state policy of providing special protection for franchisees, such as that expressed in California's Franchise Investment Law, can be recognized without impairing the basic purposes of the federal statute. Like the majority of the California Supreme Court, I am not persuaded that Congress intended the pre-emptive effect of this statute to be "so unyielding as to require enforcement of an agreement to arbitrate a dispute over the application of a regulatory statute which a state legislature, in conformity with analogous federal policy, has decided should be left to judicial enforcement." App. to Juris. Statement 18a.

Thus, although I agree with most of the Court's reasoning and specifically with its jurisdictional holdings, I respectfully dissent from its conclusion concerning the enforceability of the arbitration agreement. On that issue, I would affirm the judgment of the California Supreme Court.

JUSTICE O'CONNOR, with whom JUSTICE REHNQUIST joins, dissenting.

Section 2 of the Federal Arbitration Act (FAA) (also known as the United States Arbitration Act) provides that a written arbitration agreement "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any con-

tract."[1] Section 2 does not, on its face, identify which judicial forums are bound by its requirements or what procedures govern its enforcement. The FAA deals with these matters in §§ 3 and 4. Section 3 provides:

> "If any suit or proceeding be brought *in any of the courts of the United States* upon any issue referable to arbitration . . . the court . . . shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement . . . ."[2]

Section 4 specifies that a party aggrieved by another's refusal to arbitrate

> "may petition *any United States district court* which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter . . . for an order directing that such arbitration proceed in the manner provided for in such agreement. . . ."[3]

Today, the Court takes the facial silence of § 2 as a license to declare that state as well as federal courts must apply § 2. In addition, though this is not spelled out in the opinion, the Court holds that in enforcing this newly discovered federal right state courts must follow procedures specified in § 3. The Court's decision is impelled by an understandable desire to encourage the use of arbitration, but it utterly fails to recognize the clear congressional intent underlying the FAA. Congress intended to require federal, not state, courts to respect arbitration agreements.

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[1] 9 U. S. C. § 2.

[2] 9 U. S. C. § 3 (emphasis added).

[3] 9 U. S. C. § 4 (emphasis added). Section 9, which addresses the enforcement of arbitration awards, is also relevant. "If no court is specified in the agreement of the parties, then such application may be made to the *United States court in and for the district within which such award was made. . . .*" 9 U .S. C. § 9 (emphasis added).

I

The FAA was enacted in 1925. As demonstrated *infra*, at 24-29, Congress thought it was exercising its power to dictate either procedure or "general federal law" in federal courts. The issue presented here is the result of three subsequent decisions of this Court.

In 1938 this Court decided *Erie R. Co.* v. *Tompkins*, 304 U. S. 64. *Erie* denied the Federal Government the power to create substantive law solely by virtue of the Art. III power to control federal-court jurisdiction. Eighteen years later the Court decided *Bernhardt* v. *Polygraphic Co.*, 350 U. S. 198 (1956). *Bernhardt* held that the duty to arbitrate a contract dispute is outcome-determinative—*i. e.* "substantive"—and therefore a matter normally governed by state law in federal diversity cases.

Bernhardt gave rise to concern that the FAA could thereafter constitutionally be applied only in federal-court cases arising under federal law, not in diversity cases.[4] In *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U. S. 395, 404-405 (1967), we addressed that concern, and held that the FAA may constitutionally be applied to proceedings in a federal diversity court.[5] The FAA covers only contracts involving interstate commerce or maritime affairs, and Congress "plainly has power to legislate" in that area. *Id.*, at 405.

Nevertheless, the *Prima Paint* decision "carefully avoided any explicit endorsement of the view that the Arbitration Act embodied substantive policies that were

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[4] Justice Frankfurter made precisely this suggestion in *Bernhardt*. 350 U. S., at 208 (concurring opinion).

[5] Two Circuits had previously addressed the problem. *Robert Lawrence Co.* v. *Devonshire Fabrics, Inc.*, 271 F. 2d 402 (CA2 1959), cert. dism'd pursuant to stipulation of counsel, 364 U. S. 801 (1960); *American Airlines, Inc.* v. *Louisville & Jefferson County Air Bd.*, 269 F. 2d 811 (CA6 1959).

to be applied to all contracts within its scope, whether sued on in state or federal courts." P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, Hart and Wechsler's The Federal Courts and the Federal System 731-732 (2d ed. 1973).[6] Today's case is the first in which this Court has had occasion to determine whether the FAA applies to state-court proceedings. One statement on the subject did appear in *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U. S. 1 (1983), but that case involved a federal, not a state, court proceeding; its dictum concerning the law applicable in state courts was wholly unnecessary to its holding.

II

The majority opinion decides three issues. First, it holds that § 2 creates federal substantive rights that must be enforced by the state courts. Second, though the issue is not raised in this case, the Court states, *ante*, at 15-16, n. 9, that § 2 substantive rights may not be the basis for invoking federal-court jurisdiction under 28 U. S. C. § 1331. Third, the Court reads § 2 to require state courts to enforce § 2 rights using procedures that mimic those specified for federal courts by FAA §§ 3 and 4. The first of these conclusions is unquestionably wrong as a matter of statutory construction; the second appears to be an attempt to limit the damage done by the first; the third is unnecessary and unwise.

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[6] In *Robert Lawrence, supra*, the Second Circuit had flatly announced—in dictum, of course—that the FAA was "a declaration of national law equally applicable in state or federal courts." 271 F. 2d, at 407. One Justice in *Prima Paint* was prepared to adopt wholesale the Second Circuit's more broadly written opinion. 388 U. S., at 407 (Harlan, J., concurring). But the *Prima Paint* majority opinion did not do so. In these circumstances, the majority opinion speaks loudly by its complete silence regarding the Act's applicability to state courts.

A

One rarely finds a legislative history as unambiguous as the FAA's. That history establishes conclusively that the 1925 Congress viewed the FAA as a procedural statute, applicable only in federal courts, derived, Congress believed, largely from the federal power to control the jurisdiction of the federal courts.

In 1925 Congress emphatically believed arbitration to be a matter of "procedure." At hearings on the Act congressional Subcommittees were told: "The theory on which you do this is that you have the right to tell the Federal courts how to proceed." [7] The House Report on the FAA stated: "Whether an agreement for arbitration shall be enforced or not is a question of procedure . . . ." [8] On the floor of the House, Congressman Graham assured his fellow Members that the FAA

> "does not involve any new principle of law except to provide a simple method . . . in order to give enforcement. . . . It creates no new legislation, grants no new rights, except a remedy to enforce

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[7] Arbitration of Interstate Commercial Disputes, Joint Hearings on S. 1005 and H. R. 646 before the Subcommittees of the Committees on the Judiciary, 68th Cong., 1st Sess., 17 (1924) (hereinafter Joint Hearings) (statement of Mr. Cohen, American Bar Association). See also Sales and Contracts to Sell in Interstate and Foreign Commerce, and Federal Commercial Arbitration, Hearing on S. 4213 and S. 4214 before a Subcommittee of the Senate Committee on the Judiciary, 67th Cong., 4th Sess., 2 (1923) (hereinafter Senate Hearing).

[8] H. R. Rep. No. 96, 68th Cong., 1st Sess., 1 (1924). To similar effect, the Senate Report noted that the New York statute, after which the FAA was patterned, had been upheld against constitutional attack the previous year in *Red Cross Line* v. *Atlantic Fruit Co.*, 264 U. S. 109 (1924). S. Rep. No. 536, 68th Cong., 1st Sess., 3 (1924). In *Red Cross* Justice Brandeis based the Court's approval of the New York statute on the fact that the statute effected no change in the substantive law.

> an agreement in commercial contracts and in admiralty contracts." [9]

A month after the Act was signed into law the American Bar Association Committee that had drafted and pressed for passage of the federal legislation wrote:

> "The statute establishes a procedure in the Federal courts for the enforcement of arbitration agreements. . . . A Federal statute providing for the enforcement of arbitration agreements does relate solely to procedure of the Federal courts. . . . [W]hether or not an arbitration agreement is to be enforced is a question of the law of procedure and is determined by the law of the jurisdiction wherein the remedy is sought. That the enforcement of arbitration contracts is within the law of procedure as distinguished from substantive law is well settled by the decisions of our courts." [10]

Since *Bernhardt*, a right to arbitration has been characterized as "substantive," and that holding is not challenged here. But Congress in 1925 did not characterize the FAA as this Court did in 1956. Congress *believed* that the FAA established nothing more than a rule of procedure, a rule therefore applicable only in the federal courts.[11]

If characterizing the FAA as procedural was not enough, the draftsmen of the Act, the House Report, and the early commentators all flatly stated that the Act was

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[9] 65 Cong. Rec. 1931 (1924).

[10] Committee on Commerce, Trade and Commercial Law, The United States Arbitration Law and Its Application, 11 A. B. A. J. 153, 154-155 (1925). See also Cohen & Dayton, The New Federal Arbitration Law, 12 Va. L. Rev. 265, 275-276 (1926).

[11] That Congress chose to apply the FAA only to proceedings related to commercial and maritime contracts does not suggest that the Act is "substantive." Cf. Fed. Rule Civ. Proc. 81; Fed. Rule Evid. 1101; Fed. Rule Crim. Proc. 54.

intended to affect only federal-court proceedings. Mr. Cohen, the American Bar Association member who drafted the bill, assured two congressional Subcommittees in joint hearings:

> "Nor can it be said that the Congress of the United States, *directing its own courts* . . . , would infringe upon the provinces or prerogatives of the States. . . . [T]he question of the enforcement relates to the law of remedies and not to substantive law. The rule must be changed for the jurisdiction in which the agreement is sought to be enforced. . . . There is no disposition therefore by means of the Federal bludgeon to force an individual State into an unwilling submission to arbitration enforcement." [12]

The House Report on the FAA unambiguously stated: "Before [arbitration] contracts could be enforced in the Federal courts . . . this law is essential. The bill declares that such agreements shall be recognized and enforced by the courts of the United States." [13]

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[12] Joint Hearings 39-40 (emphasis added). "The primary purpose of the statute is to make enforcible [*sic*] in the Federal courts such agreements for arbitration. . . ." *Id.*, at 38 (statement of Mr. Cohen). See also Senate Hearing 2 ("This bill follows the lines of the New York arbitration law, applying it to the fields wherein there is Federal jurisdiction.").

[13] H. R. Rep. No. 96, *supra*, at 1. Commentators writing immediately after passage of the Act uniformly reached the same conclusion. The A. B. A. Committee that drafted the legislation wrote: "So far as the present law declares simply the policy of recognizing and enforcing arbitration agreements in the Federal courts it does not encroach upon the province of the individual states." Committee on Commerce, Trade and Commercial Law, *supra*, at 155. See also Cohen & Dayton, *supra*, at 276-277; Baum & Pressman, The Enforcement of Commercial Arbitration Agreements in the Federal Courts, 8 N. Y. U. L. Q. Rev. 428, 459 (1931). Williston wrote: "Inasmuch as arbitration acts are deemed procedural, the United

Yet another indication that Congress did not intend the FAA to govern state-court proceedings is found in the powers Congress relied on in passing the Act. The FAA might have been grounded on Congress' powers to regulate interstate and maritime affairs, since the Act extends only to contracts in those areas. There are, indeed, references in the legislative history to the corresponding federal powers. More numerous, however, are the references to Congress' pre-*Erie* power to prescribe "general law" applicable in all federal courts.[14] At the congressional hearings, for example: "Congress rests solely upon its power to prescribe the jurisdiction and duties of the Federal courts." [15] And in the House Report:

> "The matter is properly the subject of Federal action. Whether an agreement for arbitration shall be enforced or not is a question of procedure to be determined by the law court in which the proceeding is brought and not one of substantive law to be determined by the law of the forum in which the contract is made. . . ." [16]

States Act applies only to the federal-courts . . . ." 6 S. Williston & G. Thompson, The Law of Contracts 5368 (rev. ed. 1938).

More recent students of the FAA uniformly and emphatically reach the same conclusion. *Prima Paint*, 388 U. S., at 424 (Black, J., dissenting); Note, 73 Harv. L. Rev. 1382 (1960); Note, Erie, Bernhardt, and Section 2 of the United States Arbitration Act: A Farrago of Rights, Remedies, and a Right to a Remedy, 69 Yale L. J. 847, 863 (1960); Note, Scope of the United States Arbitration Act in Commercial Arbitration: Problems in Federalism, 58 Nw. U. L. Rev. 468, 492 (1963).

[14] For my present purpose it is enough to recognize that Congress relied *at least in part* on its Art. III power over the jurisdiction of the federal courts. See *Prima Paint*, 388 U. S., at 405, and n. 13 (majority opinion); *id.*, at 416-420 (Black, J., dissenting).

[15] Joint Hearings 38. See also *id.*, at 17, 37-38.

[16] H. R. Rep. No. 96, *supra* n. 8, at 1. Immediately after the FAA's enactment, the A. B. A. drafters of the Act wrote:

Plainly, a power derived from Congress, Art. III control over federal-court jurisdiction would not by any flight of fancy permit Congress to control proceedings in state courts.

The foregoing cannot be dismissed as "ambiguities" in the legislative history. It is accurate to say that the entire history contains only one ambiguity, and that appears in the single sentence of the House Report cited by the Court *ante*, at 12-13. That ambiguity, however, is definitively resolved elsewhere in the same House Report, see *supra*, at 27, and throughout the rest of the legislative history.

B

The structure of the FAA itself runs directly contrary to the reading the Court today gives to § 2. Sections 3 and 4 are the implementing provisions of the Act, and they expressly apply only to federal courts. Section 4 refers to the "United States district court[s]," and provides that it can be invoked only in a court that has jurisdiction under Title 28 of the United States Code. As originally enacted, § 3 referred, in the same terms as § 4, to "courts [or court] of the United States." [17] There has since been a minor amendment in § 4's phrasing, but

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"[The FAA] rests upon the constitutional provision by which Congress is authorized to establish and control inferior Federal courts. So far as congressional acts relate to the procedure in the Federal courts, they are clearly within the congressional power." Committee on Commerce, Trade and Commercial Law, *supra* n. 10, at 156.

Numerous other commentators writing shortly after the FAA's passage, as well as more recently, have made similar statements. See, *e. g.*, Cohen & Dayton, *supra* n. 10, at 275; Baum & Pressman, *supra*, at 430-431; Note, 73 Harv. L. Rev., at 1383; Note, 58 Nw. U. L. Rev., at 481.

[17] The use of identical language in both sections was natural: § 3 applies when the party resisting arbitration initiates the federal-court action; § 4 applies to actions initiated by the party seeking to enforce an arbitration provision. Phrasing the two sections differently would have made no sense.

no substantive change in either section's limitation to federal courts.[18]

None of this Court's prior decisions has authoritatively construed the Act otherwise. It bears repeating that both *Prima Paint* and *Moses H. Cone* involved *federal-court* litigation. The applicability of the FAA to state-court proceedings was simply not before the Court in either case. Justice Black would surely be surprised to find either the majority opinion or his dissent in *Prima Paint* cited by the Court today, as both are, *ante*, at 11, 12. His dissent took pains to point out:

> "The Court here does not hold . . . that the body of federal substantive law created by federal judges under the Arbitration Act is required to be applied by state courts. A holding to that effect—which the Court seems to leave up in the air—would flout the intention of the framers of the Act." 388 U. S., at 424 (footnotes omitted).

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[18] In 1954, as a purely clerical change, Congress inserted "United States district court" in § 4 as a substitute for "court of the United States." Both House and Senate Reports explained: " 'United States district court' was substituted for 'court of the United States' because, among Federal courts, such a proceeding would be brought only in a district court." H. R. Rep. No. 1981, 83d Cong., 2d Sess., 8 (1954); S. Rep. No. 2498, 83d Cong., 2d Sess., 9 (1954).

Even without this history, § 3's "courts of the United States" is a term of art whose meaning is unmistakable. State courts are "in" but not "of" the United States. Other designations of federal courts as the courts "of" the United States are found, for example, in 28 U. S. C. § 2201 (1976 ed., Supp. V) (declaratory judgments); Fed. Rule Evid. 501; and the Norris-La Guardia Act, 29 U. S. C. § 104, see *Boys Markets, Inc.* v. *Retail Clerks*, 398 U. S. 235, 247 (1970) (BRENNAN, J.). References to state and federal courts together as courts "in" or "within" the United States are found in the Supremacy Clause ("Judges *in* every state"); 11 U. S. C. § 306 (1982 ed.); 22 U. S. C. § 2370(e)(2); and 28 U. S. C. § 1738. See also W. Sturges, Commercial Arbitrations and Awards § 480, p. 937 (1930).

Nothing in the *Prima Paint* majority opinion contradicts this statement.

The *Prima Paint* majority gave full but precise effect to the original congressional intent—it recognized that notwithstanding the intervention of *Erie* the FAA's restrictive focus on maritime and interstate contracts permits its application in federal diversity courts. Today's decision, in contrast, glosses over both the careful crafting of *Prima Paint* and the historical reasons that made *Prima Paint* necessary, and gives the FAA a reach far broader than Congress intended.[19]

III

Section 2, like the rest of the FAA, should have no application whatsoever in state courts. Assuming, to the contrary, that § 2 *does* create a federal right that the state courts must enforce, state courts should nonetheless be allowed, at least in the first instance, to fashion their own procedures for enforcing the right. Unfortunately, the Court seems to direct that the arbitration clause at issue here must be *specifically* enforced; apparently no other means of enforcement is permissible.[20]

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[19] The Court suggests, *ante*, at 12, that it is unlikely that Congress would have created a federal substantive right that the state courts were not required to enforce. But it is equally rare to find a federal substantive right that cannot be enforced in federal court under the jurisdictional grant of 28 U. S. C. § 1331. Yet the Court states, *ante*, at 15-16, n. 9, that the FAA must be so construed. The simple answer to this puzzle is that in 1925 Congress did not believe it was creating a substantive right at all.

[20] If my understanding of the Court's opinion is correct, the Court has made § 3 of the FAA binding on the state courts. But as we have noted, *supra*, at 29, § 3 by its own terms governs only *federal-court* proceedings. Moreover, if § 2, standing alone, creates a federal right to specific enforcement of arbitration agreements §§ 3 and 4 are, of course, largely superfluous. And if § 2 implicitly incorporates §§ 3 and 4 procedures for making arbitration agreements enforceable before arbitration begins, why not also § 9 pro-

It is settled that a state court must honor federally created rights and that it may not unreasonably undermine them by invoking contrary local procedure. "'[T]he assertion of federal rights, when plainly and reasonably made, is not to be defeated under the name of local practice.'" *Brown* v. *Western R. Co. of Alabama*, 338 U. S. 294, 299 (1949). But absent specific direction from Congress the state courts have always been permitted to apply their own reasonable procedures when enforcing federal rights. Before we undertake to read a set of complex and mandatory procedures into § 2's brief and general language, we should at a minimum allow state courts and legislatures a chance to develop their own methods for enforcing the new federal rights. Some might choose to award compensatory or punitive damages for the violation of an arbitration agreement; some might award litigation costs to the party who remained willing to arbitrate; some might affirm the "validity and enforceability" of arbitration agreements in other ways. Any of these approaches could vindicate § 2 rights in a manner fully consonant with the language and background of that provision.[21]

The unelaborated terms of § 2 certainly invite flexible enforcement. At common law many jurisdictions were hostile to arbitration agreements. *Kulukundis Shipping Co.* v. *Amtorg Trading Corp.*, 126 F. 2d 978, 982-984 (CA2 1942). That hostility was reflected in two different doctrines: "revocability," which allowed parties to repudiate arbitration agreements at any time before the arbitrator's award was made, and "invalidity" or "un-

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cedures concerning venue, personal jurisdiction, and notice for enforcing an arbitrator's award after arbitration ends? One set of procedures is of little use without the other.

[21] See Note, 69 Yale L. J., at 864-865; Note, 73 Harv. L. Rev., at 1385; Note, 58 Nw. U. L. Rev., at 493.

enforceability," equivalent rules [22] that flatly denied any remedy for the failure to honor an arbitration agreement. In contrast, common-law jurisdictions that enforced arbitration agreements did so in at least three different ways—through actions for damages, actions for specific enforcement, or by enforcing sanctions imposed by trade and commercial associations on members who violated arbitration agreements.[23] In 1925 a forum allowing *any one* of these remedies would have been thought to recognize the "validity" and "enforceability" of arbitration clauses.

This Court has previously rejected the view that state courts can adequately protect federal rights only if "such courts in enforcing the Federal right are to be treated as Federal courts and subjected *pro hac vice* to [federal] limitations . . . ." *Minneapolis & St. Louis R. Co.* v. *Bombolis*, 241 U. S. 211, 221 (1916). As explained by Professor Hart:

> "The general rule, bottomed deeply in belief in the importance of state control of state judicial procedure, is that federal law takes the state courts as it finds them. . . . Some differences in remedy and procedure are inescapable if the different governments are to retain a measure of independence in deciding how justice should be administered. If the differences become so conspicuous as to affect advance calculations of outcome, and so to induce an undesirable shopping between forums, the remedy does not lie in the sacrifice of the independence of either government. It lies rather in provision by the federal government, con-

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[22] See J. Cohen, Commercial Arbitration and the Law 53-252 (1918); Sturges, *supra*, §§ 15-17 (discussing "revocability"); *id.*, § 22 (treating as equivalent different courts' declarations that arbitration agreements were "contrary to public policy," "invalid," "not binding upon the parties," "unenforceable," or "void"). See also Note, 73 Harv. L. Rev., at 1384.

[23] See Sturges, *supra*, §§ 22-24.

> fident of the justice of its own procedure, of a federal forum equally accessible to both litigants." [24]

In summary, even were I to accept the majority's reading of § 2, I would disagree with the Court's disposition of this case. After articulating the nature and scope of the federal right it discerns in § 2, the Court should remand to the state court, which has acted, heretofore, under a misapprehension of federal law. The state court should determine, at least in the first instance, what procedures it will follow to vindicate the newly articulated federal rights. Cf. *Missouri ex rel. Southern R. Co.* v. *Mayfield*, 340 U. S. 1, 5 (1950).

IV

The Court, *ante*, at 15-16, rejects the idea of requiring the FAA to be applied only in federal courts partly out of concern with the problem of forum shopping. The concern is unfounded. Because the FAA makes the federal courts equally accessible to both parties to a dispute, no forum shopping would be possible even if we gave the FAA a construction faithful to the congressional intent. In controversies involving incomplete diversity of citizenship there is simply no access to federal court and therefore no possibility of forum shopping. In controversies *with* complete diversity of citizenship the FAA grants federal-court access equally to both parties; no party can gain any advantage by forum shopping. Even when the party resisting arbitration initiates an action in state court, the opposing party can invoke FAA § 4 and promptly secure a federal-court order to compel arbitration. See, *e. g.*, *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 460 U. S. 1 (1983).

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[24] Hart, The Relations Between State and Federal Law, 54 Colum. L. Rev. 489, 508 (1954). See generally P. Bator, P. Mishkin, D. Shapiro, & H. Wechsler, Hart and Wechsler's The Federal Courts and the Federal System 567-573 (2d ed. 1973).

Ironically, the FAA was passed specifically to rectify forum-shopping problems created by this Court's decision in *Swift* v. *Tyson*, 16 Pet. 1 (1842).[25] By 1925 several major commercial States had passed state arbitration laws, but the federal courts refused to enforce those laws in diversity cases.[26] The drafters of the FAA might have anticipated *Bernhardt* by legislation and required federal diversity courts to adopt the arbitration law of the State in which they sat. But they deliberately chose a different approach. As was pointed out at congressional hearings,[27] an additional goal of the Act was to make arbitration agreements enforceable even in federal courts located in States that had no arbitration law. The drafters' plan for maintaining reasonable harmony between state and federal practices was not to bludgeon States into compliance, but rather to adopt a uniform federal law, patterned after New York's path-breaking state statute,[28] and simultaneously to press for passage of coordinated state legislation. The key language of the Uniform Act for Commercial Arbitration was, accordingly, identical to that in § 2 of the FAA.[29]

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[25] See Joint Hearings 16 (statement of Mr. Cohen, A. B. A.); Senate Hearing 2. See also Cohen & Dayton, *supra* n. 10, at 275-276; Sturges & Murphy, Some Confusing Matters Relating to Arbitration under the United States Arbitration Act, 17 Law & Contemp. Prob. 580, 590 (1952).

[26] See, *e. g.*, *Atlantic Fruit Co.* v. *Red Cross Line*, 276 F. 319 (S.D.N.Y. 1921), aff'd, 5 F. 2d 518 (CA2 1924); *Lappe* v. *Wilcox*, 14 F. 2d 861 (N.D.N.Y. 1926).

[27] Joint Hearings 35.

[28] See S. Rep. No. 536, *supra* n. 8, at 3.

[29] The Uniform Act tracked the "valid, irrevocable, and enforceable" language of § 2. See 47 A. B. A. Rep. 318 (1922). It was also hoped that other States might pattern their arbitration statutes directly after the federal Act. See, *e. g.*, Joint Hearings 28. By 1953 it was reported that arbitration statutes "quite similar" to the FAA had been enacted in 12 other States. Kochery, The Enforce-

In summary, forum-shopping concerns in connection with the FAA are a distraction that does not withstand scrutiny. The Court ignores the drafters' carefully devised plan for dealing with those problems.

V

Today's decision adds yet another chapter to the FAA's already colorful history. In 1842 this Court's ruling in *Swift* v. *Tyson*, *supra*, set up a major obstacle to the enforcement of state arbitration laws in federal diversity courts. In 1925 Congress sought to rectify the problem by enacting the FAA; the intent was to create uniform law binding only in the federal courts. In *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938), and then in *Bernhardt Polygraphic Co.*, 350 U. S. 198 (1956), this Court significantly curtailed federal power. In 1967 our decision in *Prima Paint* upheld the application of the FAA in a *federal-court* proceeding as a valid exercise of Congress' Commerce Clause and admiralty powers. Today the Court discovers a federal right in FAA § 2 that the state courts must enforce. Apparently confident that state courts are not competent to devise their own procedures for protecting the newly discovered federal right, the Court summarily prescribes a specific procedure, found nowhere in § 2 or its common-law origins, that the state courts are to follow.

Today's decision is unfaithful to congressional intent, unnecessary, and, in light of the FAA's antecedents and the intervening contraction of federal power, inexplicable. Although arbitration is a worthy alternative to litigation, today's exercise in judicial revisionism goes too far. I respectfully dissent.

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ment of Arbitration Agreements in the Federal Courts: Erie v. Tompkins, 39 Cornell L. Q. 74, 76, n. 7 (1953). See also *Ludwig Mowinckels Rederi* v. *Dow Chemical Co.*, 25 N. Y. 2d 576, 584-585, 255 N. E. 2d 774, 778-779 (1970).

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No. 87-1746

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1987

THE SOUTHLAND CORPORATION, RAY BERRY, TAL COLSON, KEITH JENKINS, ROBERT DUNCAN, JOHN P. THOMPSON, JERE W. THOMPSON, WALTON GRAYSON III, JOSEPH S. HARDIN, R.G. SMITH, EUGENE PENDER, S.R. DOLE, and TERRY DE BARD,
Petitioners,

v.

RICHARD D. and DARLA J. KEATING, MICHAEL M. AND GLORIA G. COY, and HARRY BATTERSBY on behalf of themselves and all other persons similarly situated,
Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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No. 87-1746

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OCTOBER TERM, 1987

THE SOUTHLAND CORPORATION, et al.,

Petitioners,

v.

RICHARD D. KEATING, et al.,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI TO THE SUPERIOR COURT OF THE COUNTY OF ALAMEDA, CALIFORNIA

I.

INTRODUCTION

Southland's petition for certiorari completely distorts the posture of the case. The California courts have not "acted contrary to this Court's mandate" (Petition, p. 1), nor have respondents "contradicted what they had represented to this Court" (Petition, p. 7), engaged in a "ruse" (Petition, p. 12), or attempted to manipulate the Court's procedures (Petition, p. 9). Briefly stated, this is what happened:

On the first appeal, the parties were asked by the clerk of the state court of appeal what law, state or federal, should govern the issue of whether there can be classwide arbitration. Southland responded that California law applied. Southland did not claim in either that court or in the California Supreme Court that classwide arbitration was barred by the Federal Arbitration Act.

Southland raised that issue for the first time on certiorari to this Court, which refused to hear it on the ground that it had not been raised in or decided by the California courts.[1] The case was remanded "for further proceedings not inconsistent" with this Court's opinion. *Southland Corp. v. Keating*, 465 U.S. 1, 17 (1984).

On remand, the superior court refused to reconsider the propriety of class arbitration as a federal issue instead of a state issue, on the grounds that, under California law, Southland raised the argument too late. The decision of the California Supreme Court on the first appeal was now the law of the case. Under California law, that doctrine applies not only to matters actually considered and decided on a prior appeal, but to any matter essential to the decision and in that sense "impliedly" decided. Having deliberately chosen to rely solely on state law on the first appeal, Southland was held barred on remand from recharacterizing the issue as one of federal law. Applying California law as enunciated by the California Supreme Court in its opinion on the first appeal, the superior court ordered classwide arbitration. Southland's appeal from that decision was dismissed because the order, being interlocutory, is nonappealable, and Southland's application for a

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[1] This Court's decision expressly recognized that: . . . . Southland did not contend in the California courts that, and the state courts did not decide whether, state law imposing of class-action procedures was preempted by federal law. When the California Court of Appeal directed Southland to address the question whether state or federal law controlled the class-action issue, Southland responded that *state law* did not permit arbitrations to proceed as class actions, that the Federal Rules of Civil Procedure were inapplicable, and that requiring arbitrations to proceed as class actions 'could well violate the [federal] constitutional guaranty of procedural due process.' Southland did not claim in the Court of Appeal that if state law required class-action procedures, it would conflict with the federal Act and thus violate the Supremacy Clause.

Southland Corp. v. Keating, 465 U.S. 1, 8 (1984).

In the California Supreme Court, Southland likewise argued that California law applied and did not oppose class certification on federal grounds. *Ibid.*

writ was denied. The California Supreme Court declined discretionary review.

In that posture, Southland once again seeks review of the same federal question that this Court refused to hear the first time. It is elementary that in order to maintain jurisdiction in this Court on the ground that a state court has denied a federal right, it is necessary to satisfy the requirements of state procedure for presenting the federal question in a timely and proper fashion. Ordinarily, the federal issue is presented too late in the state courts if it is raised for the first time on appeal. A fortiori, it is too late when raised for the first time on remand to the trial court following appeal.

II

ARGUMENT

A. There Is No Jurisdictional Basis for the United States Supreme Court to Review the Order

Southland's petition for certiorari attempts to present the issue whether California's classwide arbitration procedure is preempted by the Federal Arbitration Act. There are two reasons why that issue may not be considered at this juncture: (1) the California Superior Court did not decide the purported federal issue posed by Southland but based its order upon adequate and independent state grounds, and (2) the order is not final for purposes of United States Supreme Court review.

1. The California Superior Court Did Not Reach The Federal Issue Posed by Southland, But Rested Its Decision Upon Adequate and Independent State Grounds

In its statement of decision issued with its order, the superior court held as follows:

> Southland has argued to this court that the permissibility of class arbitration is governed by the Federal Arbitration Act. The court declines to consider this argument because the doctrines of invited error and law of the case preclude Southland from raising such argument at this point in these

proceedings. This court has therefor determined the propriety of class arbitration under state law.

It is a fundamental rule that this Court will not review state court judgments that rest on adequate and independent state grounds. *Herb v. Pitcairn*, 324 U.S. 117, 125, 89 L.Ed. 789, 794, 65 S.Ct. 459 (1944); see 12 Moore's Federal Practice, ¶ 511.01, pp. 8-65—8-66 (2d ed. 1982), and cases there cited. In order to maintain jurisdiction on the ground that a state court has denied a federal right, it is necessary to satisfy the requirements of state procedure for presenting the federal question at the right time and in the right way. "[W]hen . . . the highest state court has failed to pass upon a federal question, it will be assumed that the omission was due to want of proper presentation in the state courts, unless the aggrieved party in this Court can affirmatively show the contrary." *Street v. New York*, 394 U.S. 576, 582, 22 L.Ed. 2d 572, 579, 89 S.Ct. 1354 (1969).

Ordinarily the federal issue is presented too late if it is raised for the first time on appeal. *Bailey v. Anderson*, 326 U.S. 203, 205-207, 90 L.Ed. 3, 66 S.Ct. 66, 68 (1945); *Memphis Nat. Gas Co. v. Beeler*, 315 U.S. 649, 650-651, 86 L.Ed. 1090, 62 S.Ct. 857, 859-860 (1942); *Mutual Life Ins. Co. v. McGrew*, 188 U.S. 291, 47 L.Ed. 480, 23 S.Ct. 375 (1903); see discussion in Wright, Miller, Cooper & Grossman, Federal Practice and Procedure: Jurisdiction § 4022, pp. 701-703. This is an fortiori case because Southland raised the federal preemption issue in the California courts for the first time on remand *after* the first appeal. At that time it was clearly too late.

An almost identical situation was presented in *Northern Pacific R. Co. v. Ellis*, 144 U.S. 458, 36 L.Ed. 504, 12 S.Ct. 724 (1891). In that case, plaintiff Ellis had sued the railroad in Wisconsin state court to quiet title to a parcel of real estate on the basis that a deed from the county to the railroad was void as an ultra vires gift. The Supreme Court of Wisconsin affirmed a judgment for plaintiff. On remand for further proceedings in the trial court, the railroad sought to rely as a defense upon a recent decision of a federal court on the same issue between the same parties, but affecting a different parcel of land. Relying on federal law, that court had found that a similar deed from the county to the

railroad was valid. *Roberts v. Northern Pacific R. Co.*, 158 U.S. 1, 39 L.Ed. 873 15 S.Ct. 756 (1894). The Wisconsin trial court refused to consider that federal issue, and entered judgment in favor of Ellis. The railroad company again appealed to the Wisconsin Supreme Court, which affirmed on the ground that its prior decision (in which the federal issue had not been raised) was now the law of the case. The railroad petitioned the Supreme Court of the United States for a writ of error. The Supreme Court dismissed the writ. Chief Justice Fuller wrote:

> the decision of the Supreme Court of Wisconsin rested upon an independent ground not involving a federal question and broad enough to maintain the judgment. [Citation.]
>
> The Supreme Court held that by reason of its decision [on the first appeal] . . . , the rights of the parties were *res adjudicata*, and that it was itself, as the parties were, bound by its own former judgment. Its conclusion had been announced and its mandate had gone down, and it had no power upon a second appeal to review that judgment. . . . Under these circumstances the judgment of the [Wisconsin] Supreme Court is not subject to review here.
>
> . . . The judgment before us was rendered in accordance with well settled principles of general law, not involving any Federal question, ...

144 U.S. at 464-465.

The only difference between that situation and the case at hand is that here there was a petition to the United States Supreme Court after the first appeal as well as after the second. In other respects, the posture of the cases appears to be identical. The Supreme Court will not consider a federal issue which the state courts have never considered because of their own application of the doctrine of the law of the case. This limitation on Supreme Court review is clearly applicable here.

2. Southland Is Prohibited by California Law From Changing Its Position From That Taken in the First Appeal

Southland argues that the federal question was properly raised, and that the superior court erred in its application of the law of the case doctrine.[2] This argument is premised upon the assertion that plaintiffs have changed their position from contending, when the case was previously before this Court, that the California courts did *not* decide the federal preemption issue to now contending, under the law of the case doctrine, that it *was* decided. Petition, pp. 11-14. This is a fallacious argument based upon a distortion of what occurred and a misrepresentation of plaintiffs' position.

Plaintiffs have never contended that the California courts in fact decided the federal preemption issue during the first appeal. The California courts clearly did not consider the question for the reason that Southland never raised it and, when asked, advised the California courts that state law prevented classwide arbitration and that the Federal Rules of Civil Procedure did not apply. *Southland Corp. v. Keating, supra,* 465 U.S. at 8; footnote 1, *supra.*

What plaintiffs *have* said is that the California law of the case doctrine applies not only to questions expressly decided on a prior appeal, but to those that were essential to the decision and in that sense "impliedly" decided. See plaintiffs' Reply to Defendant's Opposition to Motion for Class Certification, August 22, 1986, p. 4, citing *Estate of Horman,* 5 Cal. 3d 62, 73, 95 Cal. Rptr. 433, 443, 485 P.2d 735 (1971). There is no inconsistency between the indisputable proposition that the California courts did not decide the federal preemption issue on the first round of appeals (because it was not raised) and the contention that the law of the case doctrine now bars Southland from raising the issue because it was essential to the California Supreme Court's first decision.

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[2] Whether this is so is, of course, a question of state law which has yet to be addressed by the California appellate courts.

The California Supreme Court held on the first appeal that, provided certain criteria were met, arbitration proceedings could be conducted in this case on a classwide basis. *Keating v. Superior Court*, 31 Cal. 3d 584, 613-614 (1982). It was essential to that holding that classwide arbitration was not somehow barred by federal law. The law of the case doctrine under California law applies to matters which were essential to the decision even though not raised. *Gore v. Bingaman*, 20 Cal. 2d 118, 124 P.2d 17 (1942); *Davis v. Edmonds*, 218 Cal. 355, 23 P.2d 289 (1933); *Nevcal Enterprises, Inc. v. Cal-Neva Lodge, Inc.*, 217 Cal. App. 2d 799, 804-805 (1963); see cases collected at 9 Witkin, Cal. Procedure, Appeal, § 754, p. 722 (3d ed. 1985).[3] The superior court therefore was correct in ruling that the doctrine bars Southland from raising a federal preemption issue that it had the opportunity to raise, but did not raise, on the previous appeal.[4]

California unquestionably has a legitimate interest in applying its law of the case doctrine. The doctrine has also generally been followed in the federal courts, where it is thought to serve "the dual pupose of: (1) protecting against the agitation of settled

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[3] Southland's exposition of California law at page 12 of its Petition is superficial. While it is the *general rule* that the law of the case doctrine does not extend to matters which might have been but were not presented and determined on a prior appeal (9 Witkin, Cal. Procedure, Appeal, § 753, p. 721 (3d ed. 1985)), that general rule is subject to an important exception where the particular point was *essential to the decision*. *Id.*, § 754, p. 722. The *Gore*, *Davis* and *Nevcal* cases cited in the text above are cases applying that exception. Southland relies on the general rule without even mentioning the exception, or attempting to distinguish those cases, although plaintiffs have relied upon the exception at each stage of these proceedings.

[4] The superior court in this case based its refusal to consider the federal preemption issue on the doctrines of law of the case and invited error. It was probably also justified on the basis that Southland's conduct in the state court of appeal during the first appeal constituted a waiver of any claim that the Federal Arbitration Act prevented classwide arbitration. See, e.g., *Davis v. Edmonds*, *supra*, 218 Cal. 355, 358, and *Henry v. Mississippi*, 379 U.S. 443, 450, 13 L.Ed. 2d 408, 414, 85 S.Ct. 564 (1965).

issues; and (2) assuring the obedience of inferior courts to decisions of superior courts." 1B Moore's Federal Practice ¶ 0.404[1], pp. 117-120 (2d ed. 1984), and cases there cited. As in the California courts, the federal law of the case doctrine prohibits a party who omits argument on a point of law necessarily involved in the disposition of an appeal from presenting it on a second appeal. *Ibid*, ¶ 0.404[1], p. 120, n. 15. As this Court observed long ago, "To allow a second writ of error or appeal to a court of last resort on the same questions which were open to dispute on the first, would lead to endless litigation." *Roberts v. Cooper*, 61 U.S. 467, 15 L.Ed. 969, 973-974, 20 How. 467, 481 (1858).

The same point has been made more recently by a California appellate court in applying the law of the case doctrine:

> Furthermore, it is of no consequence that the point in question was not raised by counsel on the prior appeal or expressly mentioned. [Citations] . . . [I]t becomes immaterial that the lower court upon the first trial did not choose to determine the precise legal issue. The controlling factor here is that the reviewing court did so choose—impliedly at the very least, if not expressly—in order to reach the result which it did.

NevCal Enterprises v. Cal-Neva Lodge, Inc., supra, 217 Cal. App. 2d at 805.

There is thus no inconsistency between plaintiffs' representation to this Court on the first appeal that the California courts did not consider the federal preemption issue and their position that the law of the case doctrine bars Southland from raising it now. After inviting the California courts to treat the class arbitration issue as one of state procedure and then losing on that issue, Southland may not now claim that the issue should have been decided under federal law. It is Southland, not plaintiffs, that has done "a 180 degree turn" (Petition, p. 11) and seeks to "have it both ways (Petition, p. 13)."[5]

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[5] Southland makes several other specious arguments as to why the law of the case doctrine does not apply or is not a bar to review by this Court.

3. The Order Is Not Final for Purposes of United States Supreme Court Review

Under 28 U.S.C. § 1257, this Court has jurisdiction to review only final judgments or decrees rendered by the highest court of a state in which a decision can be had.[6] The finality requirement normally is not satisfied if the state courts still must conduct further substantive proceedings before the parties' rights as to federal issues are resolved, and this Court ordinarily has no jurisdiction to review an interlocutory judgment. *Pennsylvania v.*

First, Southland asserts that the doctrine is merely a "discretionary rule" in California rather than a jurisdictional requirement. Petition, p. 13, n. 11. The California Supreme Court has made it clear, however, that state appellate courts are not free to disregard a prior appellate determination in the case unless it is at least demonstrated that such would result in a "manifest misapplication of existing principles resulting in substantial injustice." *People v. Shuey*, 13 Cal. 3d 835, 846, 120 Cal. Rptr. 83, 533 P.2d 211 (1975). Southland also suggests that the doctrine is not to be applied to "pure questions of law." Petition, p. 13. However, principles of law are exactly what the law of the case doctrine does apply to. *Tally v. Ganahl*, 151 Cal. 418, 421, 90 P. 1049 (1907). See 9 Witkin, Cal. Procedure, Appeal, § 737, pp. 705-706 (3d ed. 1985). Finally, Southland says that the doctrine is inapplicable here because intervening cases have changed or significantly clarified tha law. Petition, p. 13, n. 12. However, the California Supreme Court's decision in this case on the permissibility of classwide arbitration has not been changed or clarified; to the contrary (as Southland itself acknowledges in its Petition), the prior decision has been followed and applied by the California appellate courts. *Izzy v. Mesquite Country Club*, 186 Cal. App. 3d 1309, 231 Cal. Rptr. 315 (1986); *Gainey v. Occidental Land Research*, 186 Cal. App. 3d 1051, 231 Cal. Rptr. 249 (1986); *Lewis v. Prudential-Bache Securities*, 179 Cal. App. 3d 935, 225 Cal. Rptr. 69 (1986).

[6] Contrary to Southland's assertion at page 9 of its Petition, respondents do not contend that the Court lacks jurisdiction merely because the order at issue was entered by a trial court. Rather, respondents contend that this Court lacks jurisdiction because the order was interlocutory, and because the California appellate courts, having declined to review it for that reason, will have an opportunity to do so upon the appeal that Southland will have the right to take from a judgment confirming an arbitration award.

Ritchie, 480 U.S. ____, 94 L.Ed. 2d 40, 51, 108 S.Ct. ____ (1987).

As Southland acknowledges, the court of appeal granted plaintiffs' motion to dismiss Southland's appeal after plaintiffs pointed out that orders directing parties to arbitrate are interlocutory and nonappealable. See 9 Witkin, Cal. Procedure, Appeal, § 71, p. 95 (3d ed. 1985), and cases there cited. Under California law, such orders are reviewable on appeal from a judgment confirming the arbitration award. *Id.*; see Cal. Code Civ. Proc. §§ 1294, 1294.2. On such an appeal, Southland would be entitled to challenge the superior court's application of the law of the case and invited error doctrines and, should it agree with Southland's position on these state law issues, the California Court of Appeal presumably would then consider the federal issue whether classwide arbitration is preempted by federal law.[7] Only such a decision would be final for purposes of 28 U.S.C. § 1257. This Court lacks jurisdiction—not because the state appellate courts declined to review the order at this juncture—but because under state procedure Southland has a remaining appeal as of right.[8]

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[7] California Code of Civil Procedure, section 1294.2—which governs appeals from judgments confirming arbitration awards—provides in part: "Upon an appeal from any order or judgment under this title, the court may review the decision and any intermediate ruling, proceeding, order or decision which involves the merits or necessarily affects the order or judgment appealed from, or which substantially affects the rights of a party."

[8] The cases cited by Southland at page 10 of its Petition are not inconsistent with this proposition. In *Perry v. Thomas*, 107 S.Ct. 2520, 96 L.Ed. 2d 426 (1987), this Court reviewed a California Court of Appeal's decision affirming a superior court order *denying* a petition to compel arbitration. Unlike orders directing parties to arbitrate, orders denying petitions to compel arbitration *are* appealable in California. 9 Witkin, Cal. Procedure, Appeal, § 72, p. 96 (3d ed. 1985), and authorities there cited. Thus, once the California Supreme Court denied discretionary review, the court of appeal's decision in *Perry* was the decision of the highest state court in which a decision could be had. There is no indication in *Belknap, Inc. v. Hale*, 463 U.S. 491 (1983), that the petitioner had a remaining appeal as of right to the state courts.

Southland to the contrary, this case does not come within the exception described in *Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, at pages 482-485, 43 L.Ed.2d 328, 95 S.Ct. 1029 (1975).[9] That exception applies to situations in which a state court has written an opinion denying a federal right or claim, which opinion would otherwise remain on the books as precedent unless immediately reviewed by the United States Supreme Court, thus eroding federal policy. *Id.* at 485. There is no such decision here. The California courts have decided a procedural issue—the propriety of classwide arbitration—under state law. The California courts have not addressed the contention that the Federal Arbitration Act prohibits classwide arbitration. That contention has not been considered because under state law Southland is estopped to raise it. There is no precedent on the merits of the issue which could "erode federal policy" and thus no basis for an exception to the general rule that interlocutory judgments are not reviewable by this Court.

B. The Question Does Not Merit Review by This Court

The California courts have not addressed the federal question which Southland seeks to raise. Accordingly, this case does not present any federal question at all. But even if the issue Southland seeks to raise were present, it would not be a substantial issue. Southland's argument—that classwide arbitration is strictly prohibited by the Federal Arbitration Act—is not based on any language in that Act nor upon any federal case that has considered the point. Rather, it is a variant of the same argument that Southland has made all along, namely, that there is something

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Organization for a Better Austin v. Keefe, 402 U.S. 415 (1971), involved a prior restraint on free speech, and first amendment rights would have been irretrievably lost if the court had declined to review the ruling of the highest Illinois court on the temporary injunction.

[9] The *Cox* case describes four categories of cases in which the Supreme Court will review state court decisions on federal questions even though further state court proceedings are pending. None of the four is applicable here because each is predicated on there having been a final determination of the federal issue by the state court. 420 U.S. 469, 477. That initial predicate is lacking here because the California courts in this case have thus far declined to decide the federal issue.

fundamentally inconsistent between class action procedure and arbitration, that like fire and water, they cannot coexist. The California Supreme Court rejected that argument when it was presented as a question of state law on the first appeal. *Keating v. Southland Corp.*, 31 Cal.3d 584 (1982). The argument is no more persuasive when premised on the Federal Arbitration Act than on California law. The California statute and policy is as pro-arbitration as is the federal statute and policy.[10]

There is no basis for this Court to declare that class action procedure and arbitration are inherently irreconcilable in their goals or implementation. Class actions are considered important by both the federal and California courts.[11] Class actions serve an important function in our system of civil justice by allowing vindication of small claims which might otherwise go unprosecuted because the result would be consumed by the cost. *Gulf Oil Co. v. Bernard*, 452 U.S. 89, 99 (1981). Class actions involving such claims are of special concern to state courts since only those individual claims exceeding $10,000 are within federal diversity jurisdiction. *Zahn v. International Paper Co.*, 414 U.S. 291 (1973).

Southland's interpretation of the Federal Arbitration Act would eliminate the class action device as a procedure for resolving claims encompassed within standardized contracts containing an arbitration clause. This would have far reaching effects. Any corporation in interstate commerce could insulate itself from liability for classwide wrongs simply by including an arbitration clause in all of its contract forms. We do not believe that the

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[10] The California statute is set forth at California Code of Civil Procedure, sections 1280 et. seq. See also *Morris v. Zuckerman*, 257 Cal. App. 2d 91, 95 (1967) [The arbitration statute "reflects [s] the strong legislative policy favoring arbitration"]; *Sanserino v. Shamberger*, 245 Cal. App. 2d 630, 635 ["Since arbitration is favored . . . every intendment will be indulged to give effect to such proceedings"].

[11] *Gen. Tel. of Southwest v. Falcon*, 457 U.S. 147, 72 L.Ed. 2d 740, 102 S.Ct. 2364 (1982); *American Pipe & Construction Co. v. Utah*, 414 U.S. 538, 551 (1974); *Richmond v. Dart Industries, Inc.*, 29 Cal. 3d 462, 469, 174 Cal. Rptr. 515, 629, P.2d 23, 27 (1981).

Federal Arbitration Act was ever intended to be used by parties of superior bargaining power to achieve such an unjust result. There is nothing in the nature or purpose of the Act to prevent a state, in managing its own dockets and procedures, from neutralizing such an unfair tactic.

CONCLUSION

For the reasons stated above, Southland's Petition should be denied.

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Dated: May 20, 1988

Supreme Court, U.S.
FILED
JUN 3 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1746

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

THE SOUTHLAND CORPORATION, *et al.*,
Petitioners,

v.

RICHARD D. KEATING, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the Superior Court of the County of Alameda, California

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REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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The Petition for Certiorari anticipates, and adequately deals with, most of respondents' arguments, but the following should be briefly noted by petitioners The Southland Corporation, *et al.* ("Southland") in reply:

1. The opposition brief reinforces petitioners' argument that respondents have attempted to manipulate this Court's jurisdiction by taking inconsistent positions. Respondents' current position is that the California Supreme Court "impliedly" ruled in 1982 that a class action arbitration procedure would not be inconsistent with federal law. (Brief in Opp. at 6-7.) This is not the position they took when the litigation was previously before this Court. At that time, they argued that the state courts had decided the issue "*solely* in terms of state law." [1]

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[1] Respondents' Motion to Dismiss at 6, *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984) (No. 82-500) (emphasis added). *See also* Brief of Appellees at 13, *id.*

Respondents' effort to reconcile their contradictory positions by semantic legerdemain is illogical. It is true that the California law of the case doctrine applies not only to issues that were actually addressed in a prior opinion but also to questions that were "essential to the decision" (*see* Brief in Opp. at 7), but respondents have not explained how this principle applies to the instant case. If, as respondents have represented, the California Supreme Court ruled in 1982 only that class action arbitrations are permissible under *California* law, it obviously was not essential to the decision for the court to consider and decide that such a procedure is not preempted by federal law.

An issue is "essential" to a decision only if the court actually faced it in its analysis or could not have decided the case as it did without considering it;[2] the doctrine does not apply to other issues that might have been, but were not, raised and decided.[3] In this sense, the federal preemption issue cannot be said to be "essential" to the California Supreme Court's decision that class action arbitrations are permissible under California law. The policies underlying the Federal Arbitration Act differ from the policies underlying the California arbitration statute,[4] and the preemption issue involves different considerations than the state-law issue.[5]

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[2] *See Gyerman* v. *United States Lines Co.*, 7 Cal. 3d 488, 498, 102 Cal. Rptr. 795, 498 P.2d 1043, 1049 (1972); *Gore* v. *Bingaman*, 20 Cal. 2d 118, 124 P.2d 17, 19 (1942); *Lindsey* v. *Meyer*, 125 Cal. App. 3d 536, 542, 178 Cal. Rptr. 1, 3 (1981).

[3] *E.g.*, *County of San Diego* v. *Milotz*, 46 Cal. 2d 761, 300 P.2d 1, 4-5 (1956); *Steelduct Co.* v. *Henger-Seltzer Co.*, 26 Cal. 2d 634, 160 P.2d 804, 809 (1945).

[4] *See, e.g., Perry* v. *Thomas*, 107 S. Ct. 2520 (1987); *Southland Corp.* v. *Keating*, 465 U.S. 1 (1984), holding that California statutes and policies regarding arbitration were inconsistent with the Federal Arbitration Act.

[5] In California, as elsewhere, courts do not automatically consider federal preemption issues when interpreting state law. *See, e.g.*,

2. Respondents mistakenly rely on *Northern Pacific R.R.* v. *Ellis*, 144 U.S. 458 (1892), for the proposition that this Court lacks jurisdiction when an issue was first raised in state court after a remand from an earlier appeal. (Brief in Opp. at 4-5.) *Ellis* involved a situation where the parties were engaged in two separate suits involving title to various parcels of land, the first being in state court, the second in federal court. In the first case, the critical issue was finally resolved against the defendant by the Wisconsin Supreme Court, and became *res judicata*, without any petition for review being filed in this Court. Later, in the second action, involving different parcels of land but the same legal issues, the critical issue was resolved in defendant's favor. Defendant then attempted to relitigate the issue in the first case. The effort was rebuffed by the Wisconsin courts. This Court held that when a decision has become *res judicata* under valid state-law principles, a party cannot create federal-question jurisdiction by obtaining a different result in a different case from a federal court.

Ellis is distinguishable for several reasons. First, the defendant in that case was not attempting to raise a new legal issue on remand; it was simply trying to reopen an already decided issue on the basis of a contrary ruling obtained from another trial court in another case. Second, *Ellis* did not involve a situation where a party had avoided review in this Court at an earlier stage of the same case by taking a position contrary to the one

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San Diego v. *Superior Court for San Diego*, 67 Cal. App. 3d 361, 375, 136 Cal. Rptr. 557, 565-66, *cert. denied*, 434 U.S. 859 (1977) (earlier case finding aircraft operator liable under state law for effects of aircraft noise, without addressing federal preemption, will not be deemed to have ruled on federal preemption point); *Plumbing, Heating & Piping Employers Council* v. *Quillin*, 64 Cal. App. 3d 215, 134 Cal. Rptr. 332, 334 n.3 (1976) (when court in prior appeal applied state statute and relied on federal authority that it considered to be consistent with state law "the preemption issue was not reached").

being taken at the later stage; nor did it involve a situation where a state-law doctrine was being applied contrary to governing precedent so as to defeat this Court's jurisdiction. Third, the *res judicata* doctrine involved in *Ellis* is fundamentally different from the law of the case doctrine applied here, because the California law of the case doctrine only applies to particular issues that have been actually or impliedly decided. Here, the federal preemption issue was not previously decided, and if it *had been*, that fact would establish this Court's jurisdiction. *See Yazoo & Mississippi Valley Ry.* v. *Adams*, 180 U.S. 1, 9, 13-15 (1901).

3. Respondents misleadingly suggest that Southland took the position in the earlier appeals that state law governed. What actually occurred was this: The clerk of the California Court of Appeal asked the parties in 1979 to address the question whether the Federal Rules of Civil Procedure were applicable to class certification proceedings in the state court.[6] Southland briefly responded to the question by citing cases involving the *Erie R.R.* v. *Tompkins* doctrine and stating that state courts are free to apply "their own procedural rules in litigation involving a federal substantive right, *provided that such application does not result in the violation of a federal right.*" [7]

Southland did not further urge its federal preemption argument on the first appeal only because California law at that time appeared to disallow class arbitration, *see Vernon* v. *Drexel Burnham & Co.*, 52 Cal. App. 3d 706, 125 Cal. Rptr. 147 (1975); *Frame* v. *Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 668, 97 Cal. Rptr. 811 (1971), and Southland believed that the

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[6] Letter dated May 18, 1979, *Keating* v. *Superior Court*, 109 Cal. App. 3d 784, 167 Cal. Rptr. 481 (1980) (1 Civil 45162).

[7] [Southland's] Supplemental Memorandum of Points and Authorities in Opposition to Petition for Writs of Mandate or Prohibition at 21 n.15, *id.* (emphasis added).

California Supreme Court would adhere to this precedent. Southland did not, at any time, argue or imply that federal law would be inapplicable if California law were changed, as it was by the California Supreme Court's unprecedented creation of a class action arbitration procedure in its 1982 decision in this litigation. Since that time, Southland has unequivocally argued that such a procedure conflicts with the policies of the Federal Arbitration Act.

* * *

The substantive issue presented in the Petition merits review by this Court. Respondents have desperately attempted to avoid resolution of this important federal question by taking inconsistent positions and by persuading the California courts to ignore this Court's mandate in *Keating*. We submit that the respondents should not be permitted to succeed in their effort to defeat this Court's jurisdiction. Therefore, a writ of certiorari should be issued.

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